# SUBSIDIES AND COUNTERVAILING MEASURES UNDER THE GATT AND THE WTO AND IN THE US LAW AND PRACTICE: PARALLEL DEVELOPMENTS AND INTERACTIONS

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## Abstract

**SUBSIDIES AND COUNTERVAILING MEASURES UNDER THE GATT AND THE WTO AND IN THE US LAW AND PRACTICE: PARALLEL DEVELOPMENTS AND INTERACTIONS**

Although the number of subsidy and countervailing duty cases, both at national and WTO level is declining, they still hold centre stage in the trade wars that are the hallmark of modern international economy. Suffice it to mention the "Foreign Sales Corporations" case, the "softwood lumber" cases and the ongoing "US-EC large civil aircraft" dispute. There are several reasons for this. On the one hand, the multilateral regulation of subsidies can strongly impinge on governmental autonomy in the management of the national economy. On the other, the boundaries of subsidisation are often quite uncertain as subsidies can overlap with quite distinct areas in the public management of the economy, such as taxation.

Probably as a result of the foregoing factors, the multilateral discipline on subsidies was slow to develop and it is only with the Uruguay Round that a fully fledged, wide-ranging regime took shape, while the identification of countervailable subsidies and the conditions under which they can be countered have been left for long to domestic countervailing duty proceedings. The United States, for a long time the main user of CVD proceedings, developed a much more sophisticated and detailed regime than the GATT's. The competitive margin provided by US administrative practice has enabled it to impose its perspective on the shaping of the multilateral regime, firstly as a result of the Uruguay Round negotiations, and secondly because of the creative interpretation of the WTO rules, especially by the Appellate Body. On the other hand, in implementing the WTO regime the United States has often been able to withstand attempts to change its domestic regime, although some of its aspects are not necessarily consistent with the WTO rules.

The success of the United States, however, has been far from complete, as the US has not been able to impose its viewpoint on decisive aspects of subsidy regulation in the GATT and in the WTO system, the most conspicuous example being the interface between taxation and subsidisation and, as expected, it has suffered the backlash of such failure. But here, as in other important cases, the Byrd Amendment being the most recent, the United States has been slow in complying with the WTO decisions, showing that states are not yet prepared to surrender their national autonomy without a fight.

This thesis is compiled with material accurate to the 20th May 2007

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# INTRODUCTION

*The context of the research*

Subsidies serve a variety of objectives. They can be used to improve the competitive position of national firms, to further industrial growth and to assist regional development. Subsidies, however, can alter the flow of international trade in favour of states that grant them. Likewise, measures designed to offset subsidies, such as countervailing duties, can also profoundly alter the level of protection fixed in the schedules of concessions. Thus rules governing subsidies and countervailing measures impinge deeply on state autonomy, arguably more so than tariff reduction or the removal of quotas.

While there has been widespread awareness amongst economists and policymakers about the importance of regulating subsidies, it was only after the Uruguay Round approved the Subsidies and Countervailing Measures (SCM) Agreement that there emerged a multilateral legal framework in this area. In contrast, the international trade Community has recognised the right of a country to impose countervailing measures since the close of the nineteenth century. It was therefore left to the countries concerned to establish – although since 1947 within the boundaries set by Art. VI:3 of the GATT – what constitutes a subsidy for the purpose of national countervailing measures and the conditions and ways of its countervailability. Some states have actively exploited this possibility for a long time; many others have not been particularly concerned with this aspect of state support to their industries.

Industrial subsidy rates in the OECD countries as well as in the developing countries after an upsurge in the 1970s went into decline from the 1980s due to multiple factors, such as the need for budget stringency both in the industrial and developing world, the changed ideological climate and growing public scepticism that industrial policy can revive declining industries.[1] A similar trend characterises countervailing duty measures. In the period from 1980 to 1986, 460 cases were reported, over 60 percent of which were initiated in the United States, followed by Chile and Australia.[2] In the United States, after a peak of 60 initiations and 26 countervailing duty decisions in 1982, the number of proceedings has markedly declined from the early 1990s and it is presently dwarfed by antidumping proceedings. Yet, the economic and political impact of subsidies and countervailing measures is still prominent, as is borne out by the number of cases entertained by the Dispute Settlement Body of the WTO, and by the relevance that quite a few such cases have in stirring up the economic relationship between trading partners.

The regulation of subsidies and countervailing measures has attracted the attention of lawyers as well as economists and political scientists. The debate over the role of subsidies in promoting or inhibiting domestic and international welfare has been rather heated, with a prominent contribution of US scholars in particular with regard to the reasons and appropriate ways for countering subsidies. Already in the 1970s, American scholars, such as Barcelo' based their criticism of subsidisation on a Paretian efficiency rationale, arguing, with specific regard to export subsidies, that they decrease overall world welfare as they open up a price differential between the world price and the domestic price in the subsidising country, thus causing distribution inefficiencies.[3] Other scholars have argued that the CVD remedy can turn out to be counterproductive, as countervailing duties will often reduce the welfare of the

[1] Gary Clyde Hufbauer, "Subsidies", in Jeffrey J. Schott, ed., *Completing the Uruguay Round. A Result-Oriented Approach to the GATT Trade Negotiations* (Washington DC, Institute for International Economics, 1990) p. 94.
[2] Patrick J. McDonough, "Subsidies", in Terence P.Stewart, ed., *The GATT Uruguay Round. A Negotiating History (1986-1992)* V. 1 (Deventer: Kluwer Law and Taxation Publisher, 1993), p. 818.
[3] J.J. Barcelo' III, Subsidies and Countervailing Duties – Analysis and a Proposal, *Law & Pol'y Int'l Bus.*, 9 (1977), p. 798-800.

importing country by increasing costs for its consumers, without necessarily preventing the exporting country from subsidising [4].

However, theoretical analyses have two fundamental defects. Firstly, they often overlook other factors that from a political and macroeconomic angle are not negligible. For example, it is likely that subsidies result in goods available at lower price for foreign consumers and that extra duties are a burden on domestic consumers. Yet, countervailing and antidumping duties can be a life-line for domestic industries sinking under aggressive, and sometimes unfair foreign competition. Secondly, valid theoretical observation can be simply ignored by the decisions of the players in international negotiations, which can be determined by more relevant political and economic factors. For instance subsidies from certain countries or for certain purposes can be exempted, but they are subsidies all the same. It is, therefore, consistent with prudence and, perhaps, more interesting to focus on the process of creation of the multilateral rules, on the perspective of the main trade partners and parties to the negotiations, on the impact that the multilateral rules have on their domestic regime.

This dissertation examines the interrelation between the US countervailing duty regime and trade policy and the multilateral subsidy and CVD discipline in the GATT and WTO system. The reasons why this research focuses on the United States are quite simple and have already been partially explained. They can be summarised as follows:

1) As shown by the data above, the United States has preceded and outshone all other GATT/WTO members in developing domestic rules to apply countervailing duties and, therefore, to assess subsidies.

[4] A criticism of the efficiency maximisation approach as justification for countervailing duties is provided by A.O'Sykes, Countervailing Duty Law: an Economic Perspective *Colum.L.R.*, 89(1989), p. 214.

2) The United States has been the most active in canvassing multilateral negotiations in the subsidy and countervailing duty area and in putting forward proposals that are mostly based on its paramount national background developed over a lengthy period.
3) The United States is among the main complainants and defendants in subsidy brought to the attention of the GATT and the WTO. It is far and away the main defendant in countervailing measures complaints in cases that are at the same time considered by US courts in the light of domestic legislation, with rather different outcomes.

*The subject of the research*

This dissertation focuses on two set of issues: 1) The supposed impact of the legal perspective and of the economic goals of the United States on the multilateral regime on subsidies. 2)The allegedly protectionist bias of the US countervailing duty regime and of the multilateral rules established in particular by the Uruguay.

The commentators of the Uruguay Round negotiations usually agree on the fact that for the United States the agreement should aim at controlling subsidies, whereas for the other parties it should be an instrument to control (US) countervailing duties.[5] Subsidies and countervailing measures certainly are interlinked as the latter owe their "raison d'être" to the former, but their discipline has long been separate. The scope of Art. VI of GATT 1947 was actually much wider than that of Article XVI, allowing proceedings against forms of subsidisation not captured by the text of the latter. And this gap was not filled by the Tokyo Round. It is only with the Uruguay Round SCM Agreement that a bridge between the regulation of subsidies and the discipline of countervailing measures was constructed. The first set, therefore, looks at subsidies and their multilateral discipline. The questions we are going to answer are: to what

6 Howard. P. Marvel, Edward John Ray, "Countervailing Duties", *The Economic Journal*, 105(1995), p. 1576, note 1.

extent did the United States as a dominant player in the sequence of negotiations directed to regulate subsidies and countervailing measures succeed in shaping the multilateral regime on subsidies? If the United States did not succeed or was not entirely successful in shaping the multilateral regime what were the consequences of its failure? The second strand concerns the interaction of the countervailing duty regime of the United States – for long the dominant user of such measures – with the multilateral regime. The questions we want to answer are whether the US regime had protectionist roots and whether the uncontested influence of the United States brought about a more protectionist multilateral regime or whether the latter forced a reform of the more protectionist aspects of the US system.

As regards the first strand some explanations must be given and certain myths must be dispelled. As noted above, the conventional wisdom is that the United States firmly opposed subsidies, which seems to imply that the United States had no interest in defending areas of public management of the economy beyond the strict boundaries drawn by the neoclassical political economy, such as monetary supply, interest rate, etc. This would imply in the first place that there is an agreement on what a subsidy is. That is, the multifaceted beast called subsidy must have, notwithstanding its multiple features, a unitary fixed identity that is or can be universally recognised. Secondly, it would suppose that there is a clear boundary between states, or customs territories, that have an interest in supporting their own industries through public measures and other trade partners, prominent among which the United States, which have an interest in withstanding such measures.

The first difficulty with such a perspective is that a general agreement on the definition of subsidy is also absent in economic theory. As pointed out by the WTO Secretariat in a recent report on subsidies, even the globally adopted National Account Statistics (NACC) ignore transfers through tax breaks and soft loans which are considered as forms of subsidisation by most economists.[6] According to an often quoted statement of an American economist, "My own starting point was an attempt to define subsidy. But in the course of doing so, I came to the conclusion that the concept of subsidy is just too elusive"[7] If economics is not able to provide an absolute truth about the scope of subsidisation, from a legal angle it is imperative for the parties involved in negotiations on subsidies that certain measures fall within the purview of the multilateral regulation while others are excluded or treated in a less stringent way. Behind legal concerns lies the economic and political interest of the parties to the negotiations to secure a definition of what constitutes a subsidy that is most consistent with their perspectives and interests.

With reference to the United States the question is, therefore, whether and how the United States succeeded in imposing the approach developed in its domestic CVD regime on the multilaterall definition of subsidy; whether it managed to exclude from it some forms of tax relief aimed at promoting exports; whether it managed to exclude from the multilateral discipline measures directed at attracting investments, which are particularly widespread in a federal regime where states compete in creating a favourable environment for prospective investors; whether and to what extent it succeeded in excluding from the general discipline forms of public support of export credit largely utilized by industrial countries and regulated in international fora other than the GATT, within which the United States had a leading role.

The other side of the inquiry concerns the countervailing duty regime. In the United States, lawmakers, the executive and often the doctrine argue that countervailing measures are - or at least should be if correctly applied - an instrument against the disruptive effects of subsidies on international trade and a way to level the playing field for international competition. Their critics, American and foreign

[6] WTO, *World Trade Report 2006 (Subsidies, Trade and the WTO)*, p. 51.
[7] Ibid., p. 48, quoting Hendrik S. Houthakker.

scholars, and obviously an array of foreign governments, reply that CVDs are protectionist barriers. For the reasons examined in greater details in chapter I this thesis rejects the assumption that countervailing duties are white knights bent on slaying the trade-distorting subsidy dragon, as, in the words of Marvel and Ray, the protection cure for subsidies could be much more harmful, and, therefore, trade disruptive than the subsidies themselves.[8] Nor, in the present unsophisticated form are they a means to level the playing field between self financing national firms and government-supported foreign firms. On the other hand, the thesis is wary of the assumption that countervailing measures are a protectionist tool per se and that a single element of the CVD regime can be sufficient proof of such a feature. The fact that, as argued by Rugman, the members of the US authority entrusted with the ascertainment of one of the conditions for imposing countervailing measures, i.e., material injury, are likely to be sympathetic with domestic lobbies, does not necessarily imply that CVD proceedings result in protectionist decisions.[9] Nor are the high cost of such proceedings and of the

subsequent actions before national trade courts necessarily a mark of protectionism.

. In contrast, the first question addressed by this research is whether some specific parts of the statutes and of the implementing administrative practices are actually biased towards protectionism, that is, whether they pursue protectionist goals or have protectionist effects. A series of factors justifies this approach. Firstly, protectionism is a relative concept. From an economic perspective a measure can be viewed as protectionist if it hinders the trade flow to a greater extent than trade would be hindered in its absence or than it would be if other criteria were applied in its implementation. From a legal perspective a measure can be also considered protectionist if it is more trade restrictive than the legal benchmark to which it should

[8] Howard P. Marvel and Edward John Ray, "Countervailing"op.cit., p. 1576.
[9] Alan M. Rugman, U.S.Protectionism and Canadian Trade Policy, *J.W.T.L.*, 20(1986), p.367.

conform, or if it is more restrictive than comparable measures applied by other trade partners. Secondly, a regime like the CVD regime is not monolithic, but has many component parts. To base a general judgment of a regime on just one its components is conceptually counterproductive and, perhaps, unfair.

As regards the United States in particular the analysis must, therefore, go through different stages. First, with reference to the initial phase of the US countervailing duty regime it is necessary to ascertain whether its key components had a protectionist bias and if in the context of the existing statute alternative, more import-friendly, criteria could be adopted. Second, it is necessary to verify whether the basic principles of the US regime have actually been incorporated into the multilateral regime as it took shape in the Uruguay Round negotiations. In a third stage the analysis must again focus on the US domestic regime to see whether it is completely in accordance with its multilateral counterpart and if its enforcement in countervailing duty investigations has more import restrictive results than those allowed by the WTO rules.

The analysis developed in the following chapters will show that protectionist elements were already present in the US system prior to the Uruguay round, but were quite often the upshot of administrative practice rather than statute, though with some few exceptions like the still existing statutory criterion to calculate countervailable subsidy on certain processed agricultural products, whose farm inputs have been subsidised. This thesis also argues that the United States gained a strategic victory when in the Uruguay Round negotiations it managed to impose its viewpoint, based, in accordance with the US regime, on the benefit for the producer rather than on the cost for the budget as suggested by the majority of the parties to the negotiations. The by-product of this approach, in accordance too with the US CVD regime, was the prevailing of the idea that the benchmark to ascertain the existence of the benefit and assess its amount should be the market.

The predominance of the market paradigm could, however, entail greater leeway for protectionist ends. The budgetary cost criterion guarantees at least a verifiable assessment of the net costs of the measure under investigation. The principle of benefit from governmental measures relative to the market relies on a multiplicity of viewpoints and approaches. Which is the relevant market for the comparison, either from a geographic or economic angle? Is a domestic market strongly influenced by government policy still a reliable benchmark? If not, which other markets can be taken into consideration? Likewise, certain economic choices could be consistent with rational economic policy if the alternatives are considered from the angle of private group of companies strategy, whereas they are not rational from the perspective of an outsider investor.

Therefore, there is no single cornerstone on which to rest in deciding whether countervailing measures are "per se" protectionist, but, acknowledging the fact that such measures can be used to shield domestic industries from foreign competition, as also borne out by their frequent union with antidumping measures, a case by cases analysis must be carried out. And this assessment must be conducted with reference both to national CVD laws and administrative practice, ascertaining whether the latter is inconsistent with the former or is fostered by it.

A related question concerns the consistency of domestic CVD law and administrative practice, and that of the United States in particular, with the WTO discipline. As already noted, the present multilateral regime, which arguably has espoused the US perspective, has increased the members' room for manoeuvre in assessing subsidies and this is potentially exploitable for protectionist ends, as is borne out by the growing number of CVD proceedings outside the United States after the

Marrakesh Agreement. However, as with the animals in Orwel's farm, some are more equal than others. The question is, therefore, whether some CVD users – the US in particular - have trespassed the boundaries allowed by the present multilateral rules. The jurisprudence of the Dispute Settlement Body, and in particular the jurisprudence of the Appellate Body, has played a decisive role in interpreting rules which are far from precise and unambiguous, thus allowing great room for manoeuvre to pursue political goals which are actually the key to mediating the contrasting interests in the dispute. The question, however, is whether the Appellate Body has usurped the role of the lawmakers, i.e., the WTO members and, in doing so has ended up encouraging protectionist tendencies. Obviously, the analysis conducted in the following chapters, especially in chapter VII, refers exclusively to the subsidy and CVD regime and does not allow general conclusions, as countervailing measures cases are too small a sample of the population of cases addressed by the WTO panels and the Appellate Body. Yet, the evidence gathered by this research will show that, in the cloak of legalistic language, the Appellate Body has often taken on itself the responsibility of refereeing between the apparently contrasting goals of countering subsidisation and preventing protectionist exploitation of the defences provided by the multilateral regime. In doing so it has given priority to the first goal, without realising that not only the subsidy disease but also the protection cure constitute major challenges to continuous liberalisation of the international trading system.

*The criteria underlying the research*

Two assumptions underlie this research:

1) The analysis developed in the dissertation starts from the premise that the multilateral trade regime and the domestic regime are separate and that there is no direct effect of the former within the sphere of action of the latter. Indeed, both the Tokyo Round Agreements and the Uruguay Round Agreements have found a place in

the domestic legislation of their main parties through a dualistic approach. The Trade Agreements Act of 1979 made it clear that the agreements negotiated in the Tokyo Round were not self-executing, and equally unequivocal was the Statement of Administrative Action on the MTN Agreements[10]. A not less restrictive approach was followed by the US in implementing the Uruguay Round Agreements[11]. As to the other main partner in multilateral trade negotiations, the European Communities, the same attitude towards the implementation of GATT agreements can be inferred from the European Court of Justice's case law. [12]

Moreover, a closer look at the implementation stage shows that there is room for departure from their provisions and this opportunity has been fully exploited, at least by the main user of countervailing measures, the United States. Leebron argues that, especially with regard to anti-dumping and countervailing duties the implementing provisions constituted a rewriting of the law in existence "in part to conform it to the Uruguay Round Agreements but also to make changes otherwise desired by the Congress (usually at the behest of certain industries)"[13]. Hudec draws our attention to the fact that the US Congress in adopting the Uruguay Subsidy Agreement modified its text with regard to subsidies granted through a funding mechanism, stating that the definition of subsidy provided by the CSM Agreement was to be understood as including regulatory subsidies in line with the approach followed by the US Department of Commerce[14].

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[10] J.H.Jackson, *United States Law and Implementation of the Tokyo Round Negotiations*, in J.H.Jackson et all. (eds) *Implementing the Tokyo Round* (Ann Arbor:The University of Michigan Press, 1987), p. 169.

[11] D.W.Leebron, *Implementation of the Uruguay Round Results in the United States*, in J.H.Jackson and A.O.Sykes (eds.) *Implementing the Tokyo Round* (Oxford:Clarendon Press,1997), p.211.

[12] ECJ,Case C - 280-93 Germany v. Council (1994) ECR I – 4973;
ECJ, Case C – 469/93 Amministrazione delle Finanze dello Stato v. Chiquita Italia SpA (1995), ECR I –4558. ECJ, Case-C-149/96 Portugal v Council (1999) ECR I-8395.

[13] D.W.Leebron, *Implementation*, op.cit., p. 207.

[14] R.E.Hudec, *Essays in the Nature of International Trade Policy* (London: Cameron May Ltd, 1999), p.268

2) This dissertation does not aim at a static comparison of the multilateral discipline on subsidies and countervailing measures and the US domestic regime, but it aims at providing a dynamic analysis. Thus it focuses on a set of specific issues, involving the United States as well as the GATT/WTO and examines how a discipline gradually emerged in the two systems and how the respective regimes have interacted.

The research is, therefore, divided into nine chapters.

1) The first section analyses the political economy of subsidies and subsidisation remedies with particular reference to the countervailing duty system in the United States.

2) The second chapter deals with the developments of the multilateral discipline on subsidies and countervailing measures in the forty years preceding the conclusion of the Uruguay Round negotiations. It argues, with no pretence of novelty, that the United States played a leading role in shaping the multilateral regime, but that its sway was not absolute. In particular, as regards the relationship between fiscal regimes and subsidy discipline it failed to secure to the US fiscal approach, prevalently based on direct taxation and characterised by rather tight anti-avoidance rules, the same treatment as its Western European trading partners, which relied mostly on indirect taxes and did not always follow the world–wide income principle for income and corporation taxes.

3) The third chapter examines the main concepts and perspectives of the US countervailing measures regime that took shape in particular in the 1980s. In this context particular attention is given to the specificity rule and to the idea that the market is the only benchmark against which to assess subsidisation and its amount.

4) The fourth chapter provides an outline of the WTO subsidies and countervailing measures regime, focusing on the impact of concepts and perspectives of the US statute and administrative practice on the multilateral regime. It argues that such influence

occurred not only because of the particularly active role played by the United States in the Uruguay Round negotiations, but also as a result of the interpretation of sometimes equivocal multilateral rules by the WTO panels, and the Appellate Body in particular.

5) The fifth chapter deals with the adjudications of the WTO panels and of the Appellate Body on the consistency of some aspects of the US tax law with the WTO subsidies and CVD regime, that is, the world famous FSC-ETI cases.

6) Chapter six re-examines the US countervailing duty discipline following the implementation of the multilateral regime by the Uruguay Round Agreements Act (URAA). Two main ideas underlie this chapter: continuity between the present US CVD regime and the regime that took shape in the United States in the years preceding the establishment of the WTO; likelihood that in some cases the present US CVD regime is not perfectly in line with the WTO discipline in spite of the fact that formally the United States had implemented the multilateral regime, which was mostly shaped on the US pattern.

7) Chapter seven reviews the countervailing measure cases involving the United States adjudicated by the DSB.

8) Chapter VIII provides an overview of the ongoing debate in the Doha negotiation assessing the likelihood that the negotiations could significantly alter the pattern established by the previous round.

9) The final part ascertains the existence of a common pattern based on the analyses carried out in the preceding chapters.

## CHAPTER I

## THE POLITICAL ECONOMY OF SUBSIDIES AND COUNTERVAILING MEASURES

### Introduction

The interface between subsidies, countervailing measures and the other remedies that are available under the GATT/WTO regime are at the centre of the debate over protectionism, free trade, and fair trade that has been going on for the last thirty years among economists, political scientists as well as lawyers. Any analysis of the SCM GATT rules and their US counterpart calls for a theoretical sextant, that is, a conceptual framework that could shed light on the economic and political impact and rationale of such measures. Yet, the tools provided by political economy theory are far from possessing astronomical precision or, at least, the reading is not straightforward. Three questions, at any rate, are of particular prominence:

First, the role and impact of subsidies and countervailing measures in the international economy. By this we have no pretence to an economic theory. What is relevant is an assessment of the function which they are actually assigned to by policymakers. Indeed, the changing perspective in their goal and usefulness can powerfully mould the legal fabric both at national and multinational levels.

Second, the goal of countervailing measures with particular reference to US trade policy.

Third, the influence that the institutional framework and its changes have on the trade policy of its main user, the United States, and in particular on the implementation of its countervailing duty regime.

**1) Subsidies from an international political economy perspective**

The period that immediately followed World War II saw state aids to national

industries soar to unprecedented levels. The 1947 General Agreement on Tariffs and Trade acknowledged the new phenomenon, and to a certain extent sanctioned its legitimacy, while at the same time recognising the right for a Contracting Party to adopt countermeasures aimed at neutralising their effects on the importing country's economy. These aids were, and still are, mostly used as contingent measures aimed at assisting particular industries in temporary difficulties or at enhancing their ability to compete in the domestic and foreign market. Sometimes these measures were part of a wider industrial policy directed at creating the hot bed for particular industries which were to act as spearhead of national economic development as a whole, even though it is difficult to draw the borderline with former case: the aid bestowed to the Italian private car industry and to the IRI (Istituto per la Ricostruzione Industriale) steel sector, private in structure but indirectly owned by the state, are one of the earliest and main examples in Europe, but certainly not the only one.[1] Since the 1950s Japan adopted a managed trade model for over 4 decades – later followed by some of East Asia NICs – to foster the rise of globally competitive firms in selected sectors that promised long-term growth. This policy coupled credit control and imports with direct subsidies, tax relief, and other forms of public support to private firms.[2]

On the other hand, the aftermath of the first oil shock, which ushered in a long spell of deteriorating economic environment in the western industrialised world witnessed the growth of the so-called non-tariff barriers (NTBs) directed at

[1] See Matthia Kipping, Ruggero Ranieri and Joost Dankers "The Emergence of New Competitor nations in the European Steel Industry:Italy and the Netherlands,1945-65, *Business History*, *43(2002)*,p.69.

protecting declining industries. Bhagwati distinguished two kinds of non-tariff barriers: high- track NTBs that bypass GATT's rules of law by negotiating restraints on exports, such as Orderly Marketing Agreements and Voluntary Export Restraints, and low- track restraints that, although GATT consistent in nature, are exploited to hinder import flows, such as antidumping and countervailing measures.[3]

Prior to the Uruguay Round Agreement antidumping duties were adopted by most industrialised countries, whereas countervailing duties were mainly the preserve of the United States which, obviously, considered them not as a trade distorting measure but as the bulwark of fair trade against state interventionism in the rest of the industrialised world and in developing countries. Indeed, some commentators have argued that since the Tokyo Round, the United States has focused on controlling subsidies whereas its counterparts have aimed at creating a legal framework to keep US countervailing duties in check.

The identification of countervailing measures is quite straightforward, as they come down to an extra duty imposed on imported goods found to have received a subsidy. Nevertheless, the conceptual framework of subsidies is less clear. Economists tend to agree on identifying four elements, with reference at least to industrial subsidies.[4] First, there must be a transfer from the governmental sector, which directly or indirectly benefits some concerns, either in terms of expenditure or forgone revenue [5]. Second, the recipient must be outside the administrative sector. That, however, does not mean that public owned companies

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[2] Bruce E. Moon, "Ideas and Policies", in Brian Hocking and Stuart McGuire, eds., *Trade Politics. International, Domestic and regional Perspectives* (London:Routledge, 1999), p. 47.
[3] Jadish Bhagwati, *Protectionism* (Cambridge,Massachusetts:The MITT Press, 1988), p. 43
Anne O. Kruger *American Trade Policy. A Tragedy in the Making* (Washington D.C.:The AEI Press, 1995) p. 37
[4] Colin Wren, *Industrial Subsidies* (London McMillan, 1990), p.5
[5] Direct subsidies can be bestowed through price and income support. These subsidies are prevalently used to lend assistance to agricultural producers but are not limited to this sector.

cannot be counted among the beneficiaries of a subsidy. Third, the government must receive no equivalent compensation in return for the transfer. Finally, the intervention must aim at affecting a given or expected outcome of the market through a change in the relative price in favour of the subsidised product.

Economists, however, differ on the relevance of certain aspects of the broad picture and on the inclusion of particular cases within the subsidy frame. Thus, some scholars have argued – and we shall see that this assumption has a range of effects on domestic countervailing case law and on GATT/WTO cases - that a subsidy can still exist if a benefit is conferred, even though there is no budgetary consequence. An often quoted example is the provision of credit by a governmental agency at rates above those paid by the agency when borrowing, but below those likely to be charged to a loan recipient if forced to borrow on the open market. Likewise, as shown by the CAP of the European Union prior to the MacSherry reform, price support to producers does not necessarily result in a burden for government budgets as the weight of higher prices is quite often prevalently borne by consumers. There is, however, a benefit for the producer and the consumer bears the cost only through a complex mechanism that insulates the economy from foreign competition.[6]

Also, public procurements and defence spending are often viewed as a potential form of public support to domestic firms[7]. The argument that public procurements and defence programmes entail compensation is counteracted by pointing to the exclusion of foreign competitors in bidding or to actions that

[6] Total transfers to farmers equal transfers from both taxpayers and consumers (less any budget revenue earned from government). Notably in the pre-Uruguay Round context, the weight of the second was particularly great due to the complementary effect of price support in the internal market (coupled with direct income support) and variable import levies that insulated the Community's markets.

[7] See Daniel M. Malkin, Assistance to industry and industrial adjustment: an overview of the economic effects of industrial subsidies, in Ronald Gerritse, ed., *Producer Subsidies* (London:Pinter Publishers, 1990), p.52.

discriminate against them when they are able to offer better terms. It is argued that in such instances the contract price is far from the price which would prevail in a free market. The inclusion or exclusion of such forms of hidden support within the scope of subsidy is of particular relevance. It has been observed that, in contrast with the EU and Japan, the involvement of a number of high technology companies in military programmes has been the main tool used in the US to secure public R&D financing and to provide a lifeline to firms in difficult times.[8]

Finally, the well-established distinction between export and domestic subsidies turns out to be rather blurred as both the intent and the effect of many government actions cannot be easily segregated between purely export oriented and domestic industrial aid, as is borne out by the support offered to national champions and strategic industries.[9]

Many economists tend to consider subsidies and countervailing measures as two sides of the same coin, that is, as forms of state intervention which interfere with the functioning of free trade, limiting the "invisible hand's" benefits. Subsidies in particular, according to classical economic theory, can be expected to have two principal effects: they will reduce either the costs of a product to the manufacturer, or the cost of a product to the consumer. In either case more of the product will be sold or produced than an efficient marketplace would have allowed. As a result resources are diverted from efficient concerns where they would yield the highest return in the market to the subsidised industry where they yield an artificially high return. Thus, conventional wisdom dating back to Adam Smith's " the Wealth of Nations" considers them as harmful to the

[8] A good illustration of this argument is provided by Robert O'Brien, *Subsidy Regulation and State Transformation in North America, the GATT and the EU* (Houndmills and London: MacMillan Press Ltd, 1997) p. 46 and p. 142.
[9] See Ronald A. Cass and Stephen J. Narkin, Antidumping and Countervailing Duty Law:The United States and the GATT" in Richard Boltuck et al., eds, *Down in the Dumps* (Washington D.C. Brooking Institution, 1991), p. 221

subsidising country, beneficial to other countries and harmful to the world economy as a whole.[10] Specifically, export subsidies are viewed as specular to tariffs as the latter direct too many productive factors into domestically produced goods while the former divert too many resources into foreign trade items. Therefore, according to the viewpoint of classic theory, they cause a misallocation of world resources as they encourage producers to expand export production to levels that are above the marginal social cost in the subsidising country and at the same time undercut foreign competitors by providing goods at prices lower than the real market value[11]. Likewise, domestic subsidies, and selective domestic subsidies in particular, are deemed to cause an increase in the subsidising country's export schedule and a decrease in its import demand schedule as they compel foreign producers to accept a lower price and a smaller volume of sales[12]. Moreover, according to some scholars, they are not apt to offset the underlying market distortions they are sometimes supposed to counterbalance, and, on the contrary, they tend to increase such problems by postponing market adjustments.[13]

Some scholars rest on public choice theory to explain public authorities' willingness to accept, with regard to subsidies, a burden for the budget without any reasonable prospect of an increase in the country's welfare, or, with regard to countervailing duties, a reduction in consumer welfare. Public actors, whether lawmakers or members of the executive at various levels, subordinate their choices to the demand of interest groups able to exercise lobbying and to which

[10] This conclusion, however, seems to rely on a perfect competition premise which is rather unrealistic in modern economy. Modern developments point out that in an oligopolistic market, below a certain level, subsidies to exporting firms reduce the welfare of the importing countries. This occurs because exporting firms are able to capture more profit in the importing country without causing a decrease in import price sufficient to bring about an offsetting enhancement of consumer surplus. See Avinash Dixit, "International Trade Policy for Oligopolistic Industry", *Economic Journal-Conference Papers* 94 (1984), p. 14.

[11] See Robert E. Baldwin, *Non Tariff Distortion of International Trade* (Washington D.C.: The Brooking Institution, 1971), p.46.

[12] Ibid., p. 111.

[13] See, with specific reference to the UK experience, Colin Wren, op.cit., p. 210.

their perspectives of re-election or career improvement are linked. On the other hand, competing groups that are not able to make their voice heard through a significant pressure on decision-makers will not receive corresponding protection in spite of the fact that the satisfaction of their interests could better contribute to the general welfare.[14] In this context subsidies and other political instruments that are used to raise the welfare of more influential interest groups result from and encourage rent seeking behaviour by market actors.

Public choice analysis, however, is not able to explain some recent tendencies in world economy. For instance, pressure of interest groups should lead to continuous high levels of subsidisation to provide a competitive edge to domestic industries vis-à-vis foreign competitors. Yet, due probably to the mounting pressure of debts on government, in recent decades there has been a net decrease in rates of subsidisation, which has not been confined to western economies. Public choice theory explains why industrial pressure prevails over the claims of consumers. It fails, however, to disaggregate complex competing interests between firms and even within firms[15] Thus, subsidies and countervailing measures favoured by industries that aim at increasing their share in the domestic market could be opposed by export-oriented industries. The same firm that benefits from the imposition of countervailing duties on foreign competitors can be disadvantaged by retaliatory restrictions imposed by trading partners.

Other scholars propose a rather less particularistic view of public actors' choices. For instance, some economists, especially prior to the 1980s lost decade, have contended that subsidies, and export subsidies in particular, can play a useful

[14] An analysis of the US institutional trade policy from a public choice perspective is provided by Robert Baldwin, *The Political Economy of US Import Policy* (Cambridge, MA: The MIT Pres, 1985).

role in the development process by increasing the absorbing capacity of industries where developing countries can have a competitive advantage in the future; by offsetting disadvantages which exporting industries have to face due to the hindrances inherent in a backward economy, such as inferior infrastructures and limited financing facilities; and by fostering, through sales in foreign markets, the achievement of scale economies for key industries.[16] More recent theories argue that, at least in some fields deemed to have a pivotal role for the national economy, the rationale for state intervention rests on an economic environment quite different from the one suggested by classic theory, in which subsidies and countervailing duties are irrelevant or even counterproductive measures. In an environment where scale economies, R&D and interest rate differentials are a decisive factor in competition between firms and, by their intermediaries, between national economies, state intervention, either by subsidies or other forms of protection, considers trade as a variable that cannot be ignored: the increase in the share of international trade expands market size, allowing scale economies and improving the ability to compete in an imperfectly competitive market. On the other hand, the interventionist state must take into account the reaction of other players in trade competition, which, however, does not coincide necessarily with retaliation.[17]

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[15] See Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade* (London: Routledge, 1999) p. 16.

[16] Lorenzo, L.Perez, Export Subsidies in Developing Countries and the GATT, 10 *J.W.T.L.* (1976), p. 531.

For an analysis of the pros and cons of export subsidies with reference to developing countries see Bela Balassa and Michael Sharpston, *Export Subsidies by Developing Countries: Issues of Policy*, (Geneva:Graduate Institute of International studies, 1977).

The idea that subsidies are needed to correct market imbalances still seems to underlie the stance of many developing countries in the current Doha Round debate. See, for instance: Agreement on Subsidies and Countervailing Measures/Anti-Dumping Agreement. Submission by India (TN/RL/W4, 25 April 2002).

[17] James A. Bauder, Rationale for Strategic Trade and International Policy, in Paul R. Krugman (ed.) *Strategic Trade Policy and the New International Economy* (Cambridge Massachusetts: The MIT Press, 1988), p. 43

Further refining this approach, Busch has recently argued that policy makers in deciding whether to subsidise strategic industries or to react to foreign subsidies take into account not only the interests of the industries directly concerned, but their externalities too. Therefore in shaping public intervention policies two variables are considered: the "consumption" variable and the "internalisation" variable. These variables determine the choice between intervention, non- intervention and limited intervention[18] The consumption variable refers to the capacity of the economy to absorb the external benefits provided by a strategic industry either through upstream or downstream flows. The internalisation variable concerns the scope of the externalities provided by the leader industry, that is, whether and to what extent they spread beyond national borders. In deciding their policy, potentially competing states will, therefore, assess first whether each economy can consume the externalities, and second whether these externalities spread beyond national borders to the advantage of foreign industries. It follows that a state whose economy can both consume and internalise the externalities exhibited by national champions is likely to subsidise these industries, whereas if the national economy is not able to consume these externalities it will opt for non-intervention. Finally, if the economy can consume but cannot internalise, it will be likely to adopt a policy of limited intervention. On the other hand, potentially competing states are likely to react, either by way of countervailing duties or by demanding the end of subsidisation in international fora, when they cannot absorb the external benefits in question, while they will not react when their economy is able to absorb a quota of the externalities.[19]

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[18] Marc L. Bush, *Trade Warriors*(Cambridge:University Press, 1999), p.16 .

[19] Ibid. The author applies this scheme to a series of cases, some of which have come under GATT attention. Thus, in a structure, such as civil aircraft, characterised by a high level of externalities which can be internalised, states have lavishly supplied export and R&D subsidies, concurrently contrasting subsidising measures adopted by their rivals. The Agreement reached in the early 1990s (and respected for over ten years) between the US and the European Communities just put a

It can be argued that, in contrast with public choice theory, the strategic trade policy approach assigns a more active role to the Executive, which does not confine itself to reacting to the lobbying of specific economic sectors, but takes into account sectors that apparently are not direct beneficiaries of its support. Secondly, the options left open to a state when another economic actor is subsidising are not limited to either countervailing or pursuing the repeal of the measure in question, but can extend to non-intervention. The availability of this option, however, could be limited by the automatism that at present characterises countervailing measure procedures. In practice, the decision by the Executive to follow a non-intervention policy in view of the benefit that could accrue to sectors of the economy other than those competing with subsidised industries could be frustrated by the latter's decision to start a countervailing procedure.

The foregoing analysis does not exclude that in sectors other than those of strategic importance the political economy choice can be determined by other factors, among which lobbying of various economic groups figures prominently. Therefore, it could be safely argued that government support, either by subsidies or countervailing measures, is not based on a single rationale. The underlying motivation can vary according to the economic bearing of the industries concerned and the role they play in the national economy.

## 2) The Role of countervailing measures with particular regard to US trade policy

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ceiling on state intervention and made it more transparent. On the other hand, the High Definition Television (HDTV) market, which is characterised by strong externalities, by a low Japanese internalisation capacity and by a low US consumption variable has been marked by limited intervention by the two main players. In the semi-conductor market where high externalities are coupled with low internalisation capacity for all competitors, the prevailing tune has been co-operation established through bilateral agreements.

As with subsidies, two opposite outlooks compete in assessing the nature and function of countervailing duties: those that consider countervailing measures as non- tariff barriers and those that view them as an instrument to redress the distortions brought about by subsidies. The first step, therefore, is to examine, with particular regard to the United States, the role of countervailing duties as is borne out by statutes and their administrative implementation.

As their name suggests, the alleged goal of countervailing measures is to contrast subsidies and their effects.[20] That, however, provides no details on the aim actually pursued in counteracting subsidies and, consequently, on the extent of the countermeasure.

Two rationales for countervailing measures have been offered by US scholars and policymakers who deny the accusation of protectionism: 1) to fight inefficient practises that prevent the optimal allocation of resources, thus decreasing world welfare; 2) to help domestic producers vie against forms of foreign competition considered unfair because they do not stem from autonomous advantages but are rooted in public intervention, that is, interference with the market.

As regards Congress, if the Uruguay Round Agreements Act does not offer a judgement on subsidies, the Senate Report on its predecessor, the Trade Agreements Act of 1979, states that "subsidies are bounties or grants bestowed (usually by governments) on the production, manufacture or export of products, often with the effect of providing some competitive advantage in relation to the product of another company....Subsidised competition may harm US producers in our own market or in foreign markets".[21] US lawmakers, therefore, stress in their

[20] See Tariff Act of 1930, section 1671.
[21] U.S. Congressional and Administrative News, 96th Congress – First session, 1979.Trade Agreements Act.( P.L. 96-39), p. 37.

statement the defence from unfair competition. The Executive does not provide a definitive definition of what should be the purpose of US countervailing duty law. The "Notice of Proposed Rulemaking and Request for Public Comment circulated in 1989"[22] – to which the present "Countervailing Duty Final Rule" of 1998 refers[23] – defined subsidies as a "distortion of the market process for allocating an economy's resources". The USTR - DOC joint report for the year 2002 refers to the deterrence of distortive subsidisation and to the prevention or remedy of harms caused to US workers and producers[24]. The emphasis seems, therefore, to be placed on the misallocation of trade resources as well as on the protection of US industry.

What is really relevant, however, is the regulation that the administering authority applies in countervailing duty investigations. As Diamond remarks, the International Trade Agency's basic approach to the assessment of a subsidy, and consequently of the countervailing measure, centres on the difference between the market benchmark and what the firm receives or pays, usually measured in cash flow terms[25].

Some scholars have argued that such an approach is inconsistent with a progressive reading of US law which aims at providing protection to domestic industries which, due to foreign governments' intervention, are forced to compete on terms far from a level playing field. These scholars contrast the "deterrence approach", adopted, in their view, by the US Administration with the "neutralisation approach" which, they argue, fulfils the task at present assigned by the law to countervailing measures offsetting the effect of the grant bestowed on

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[22] 54 FR. 23,366.
[23] 63 FR 65347.
[24] Subsidies Enforcement. Annual Report to the Congress. February 2003. http://ia.ita.doc.gov/esel/reports/seo2002/2002.html
[25] See Richard Diamond, "A Search for Economic and Financial Principles in the Administration of United States Countervailing Duty, *Law & Pol'y Int. Bus.* 21 (1990), p. 520.

foreign competitors[26]. According to this argument, the deterrence approach aims at overbalancing the advantage of the subsidy by erasing the value of the grant, thus discouraging foreign firms from accepting it, and has as its rationale the alleged interference of the subsidy with the efficient allocation of productive resources. Starting from this assumption it is argued that the deterrence rationale is inconsistent both with economic theory, as it does not take into account the corrective aims of the grant, in particular when the market fails to acknowledge the social value of some productive activities, and with the GATT itself which rejects claims that all subsidies are per se improper.[27] A refinement of this criticism also argues that the measures grounded on this rationale are sometimes ineffective as they can either overshoot or not completely cancel the advantage the subsidies confer on foreign competitors. On the other hand, the neutralisation approach is claimed to offer the means of dovetailing the effects of a subsidy on the power of foreign competitors to sell either more goods or goods at a lower price, thus displacing domestic producers. It is, therefore, argued that countervailing measures consistent with US law should offset the decrease in marginal costs allowed by the grant.[28]

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[26] Charles J. Goetz et All., "The Meaning of Subsidy and Injury in the Countervailing Duty Law", *Int'l Rev.L&Econ.6*( 1986*)*, p.520.

[27] Richard Diamond, Economic Foundation of Countervailing Duty Law, *Va.J.Int'l.L.*29 (198*9)*, p.779

[28] Ibid., p. 778.

The article provides a mathematical demonstration of the availability of countervailing measures that offset subsidised competition against domestic producers. As they are essential in understanding the author's reasoning, we report the equations concerning

a) quantification of duty when payments have a constant effect on marginal cost of production $dV = (M'/M' - C') \times dS$; and
b) calculation of duty where the effect of payments on marginal costs varies with production: $dV = (M'/M' - C' + S') \times d\epsilon$

Where M, is the revenue function of the subsidised firm; X, the quantity which it sells in the market; C, the firm's marginal cost of production; S, the per unit amount of government payments; V, the per unit amount of countervailing duties; and $\epsilon$ is a variable added to allow small changes in the value of S without changing the slope of its function.

In both cases the model determines the needed amount of countervailing duty once we know the amount of subsidisation, market price, and the firm's marginal costs. The model, however, is not concerned with fixed costs.

This theory, though well argued, presents a series of drawbacks both from the economic and the legal angle. From the economic angle, if it provides an instrument to counteract the decrease in variable costs, it fails to provide an equivalently reliable means when subsidies are directed to fixed costs, as the latter only affect the marginal cost curve indirectly. Certainly, subsidies that increase capital investments lower the marginal cost of production and lead to an increase in output. [29] The question, however, is: how far do they affect the marginal cost function? Secondly, while subsidisation of variable costs is necessarily directed to ongoing production, subsidies to capital investments can aim at offsetting costs already incurred, and in such a case they do not influence ongoing variable costs. In short, with regard to the subsidisation of capital investments, the neutralisation approach would require a knowledge of firms' choices which present countervailing duty investigations are not prepared for and could only be achieved through a thorough reassessment of such measures and, perhaps, their integration with other policies such as international competition.

From the legal angle the "neutralisation approach" does not take into account the text of the law at the time the analysis was formulated and as it stands now. Indeed, section 1671 of the 1930 Tariff Act, as amended, provides that "if the administering authorities determine that the government of a country is providing ...a countervailing subsidy... there shall be imposed upon such merchandise a countervailing duty equal to the net amount of the countervailable subsidy", leaving no room for manoeuvre to the Administering Authority if it wished to apply a countervailing duty that differs from the assessed amount of the

[29] See, Barbara J. Spencer, "Countervailing Duty Laws and Subsidies to Imperfectly Competitive Industries", in Robert E. Baldwin et All., eds, *Issues in US-EC Trade Relations* (Chicago:The University of Chicago Press, 1988), p. 326.

grant.[30] In turn, the ITA Final Rule makes it clear that "in analysing whether a benefit exists we are concerned with what goes into a company such as enhanced revenue or reduced costs.....not with what the company does with the subsidy".[31]

On the other hand, those who support the "neutralisation approach" have succeeded in showing the limits of the present US countervailing duty regime either in contrasting international trade distortion or in securing a level playing field for US firms besieged by unfair foreign competition, as countervailing duties are unsophisticated measures, concerned with average total costs rather than marginal costs, which can decrease domestic consumers' welfare and often overbalance foreign subsidies without being able at times to completely neutralise their impact on domestic producers.[32]

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[30] A more flexible provision is embodied in Art VI:2 of the GATT which states that "no countervailing duty shall be levied in excess of an amount equal to the estimated bounty determined to have been granted", thus leaving open the door for an amount of duty lower than the grant, if that is considered appropriate by the administering authority.

[31]. Federal Register 65347, 65361.

[32] A simple numerical example can help clarify this argument:

Imagine that country A's firms produce 1,000 widgets per year. All of them are exported from country A to country B which applies a 3% ad valorem duty.

The exchange rate between country A and B is EU 1 = $1.

Without subsidisation the cost of production would be

| | |
|---|---|
| 1) Plant and machinery (fixed cost) EU 10,000,000, with a 10 year depreciation period. Applying a straight-line method, the cost in year X is | EU 1,000,000 |
| 2) workers costs (variable) | EU 200,000 |
| 3) cost of materials | EU 300,000 |
| Total Cost | EU 1,500,000 |
| Unit cost | EU 1,500 |
| In country B, after having paid the duty the average cost is | $ 1,545 |

Now, suppose that EU 1,000,000 are bestowed to country A's companies for plant and machinery purchases. This reduces the cost to EU 9,000,000.

To avoid lay-offs a 10% subsidy is granted to offset workers costs.

Supposing, for sake of simplicity, that the effect of the grant is spread over a period equivalent to the depreciation period in year Y, the production costs are as follows.

| | |
|---|---|
| 1) Plant and machinery | EU 900,000 |
| 2) workers costs | EU 180,000 |
| 3) cost of materials | EU 300,000 |
| Total cost | EU 1,380,000 |
| Unit cost | EU 1,380 |

As there is a cost reduction of EU 120 (8.695% of EU 1,380) due to country A's subsidisation, country B applies a 8,695% countervailing duty. The unit cost of the widgets in country B will be. $ 1,380, plus 8.695% countervailing duty, plus 3% import duty= $ 1,541.4.

Countervailing measures, therefore, neutralise any reduction of tariff protection, surreptitiously achieved by the exporting country because of the provision of public aid.

The current regime, however, is unconcerned by the fact that subsidised purchases of new plants and machinery could boost productivity in country A, which, for instance, could now produce

The inability of countervailing measures to fulfil the above-mentioned goals brings us to look elsewhere to find their real rationale. The answer to the quest can be found if we look at their historical background, and such a background points to the idea of reciprocity which is still a landmark of American trade policy and finds full recognition in the multilateral regime. Indeed countervailing measures are an unsophisticated tool to re-establish, at face value, the balance of benefits accruing either under a bilateral or a multilateral agreement in which any concession is presumed to have a counterweight.

Reciprocity, which had played a role in US trade policy since the end of the nineteenth century, became pivotal in US trade relations starting with the Reciprocal Trade Agreements Act of 1934. The act, while confirming the unconditional MFN principle, required trade concessions to be conditional on the receipt of equivalent concessions from the trading partner in bilateral negotiations.[33] Expectation for reciprocity was later extended to the GATT multilateral regime as a counterweight to the MFN and National treatment principles.[34] Contrary to what has been often stated, the requirement finds explicit recognition in the GATT/WTO architecture. Acknowledgement of this principle can be found, for instance, in the Preamble of GATT which speaks of "reciprocal and mutually advantageous arrangements". Art. XXXVI states that "the Contracting Parties do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of the

1,200 widgets per year decreasing the average cost of exports to country B to just 1,150 thus displacing country B's domestic producers. Indeed, the countervailing duty on each imported item, which amounts to the gap rate between the original cost per unit and the cost net of subsidy, is not enough to offset the price decrease:
Subsidy on item sold: EU 100 = $ 100 = 8.695% of $ 1,150;
CVD = 8.695% . $ 1,150 = $ 100;
Import price = $ 1,150 + $ 100 + 34.50 = $ 1,284.5: a far cry from the original, unsubsidised, cost of the widgets.

[33] See Carolyn Rhodes, *Reciprocity, U.S. Trade Policy and the GATT Regime* (Itaka :Cornell University Press, 1993) p. 53 et seq..

[34] Ibid. p. 77.

less developed Contracting Parties", thus implying that they do expect reciprocity for commitments to Parties other than less developed countries. Congress has constantly asserted the reciprocity requirement as a condition for granting the Executive trade authority in multilateral negotiations.[35]

However, reciprocity is a multifaceted concept. Swan argues that in the changing pattern of modern economy two forms of reciprocity have taken shape: diffuse and specific reciprocity.[36] The former, which is at the basis of section 301 of the Trade Act of 1974, aims at a general balance of concessions and is, therefore, characterised by a less precise definition of equivalence. The latter, examples of which are provided by the successive Rounds of Trade negotiation under the aegis of the GATT, implies a simultaneous exchange of concessions, either bilateral or multilateral, which gives rise to obligations clearly specified in terms of gains and duties. Within its scope a commitment received is always a commitment paid for. The goal of countervailing duties can be understood in the frame of specific reciprocity

As Feller notes, at the outset the countervailing duty law was intended as a repair mechanism to ensure the integrity of the trade wall. Its aim was to protect the interests behind that barrier rather than competition as such.[37] Twenty five years later another scholar observed that the International Trade Administration does not focus on the competitive disadvantage felt by US business but on the

[35] With regard to the Omnibus Trade Act and Competitiveness Act of 1988, bestowing the negotiating authority for the Uruguay Round to the President, see David W. Leebron, "Implementation of the Uruguay Round Results in the United States" in John H. Jackson and Alan O.Sykes,eds., *Implementing the Uruguay Round* (Oxford:Clarendon Press, 1998) p. 185.

[36] Alan C. Swan, "'Fairness' and 'Reciprocity' in International Trade. Section 301 and the Rule of Law", *Ariz.J.Int'l & Comp.Law* 39 (1999). web.lexis-nexis.com/professional.

[37] Peter B. Feller, "Mutiny against the Bounty: An Examination of Subsidies Border Tax Adjustments", *Law &Pol. Int'l.Bus.1* (1969), p. 22. Feller, however, argued that the goal of countervailing measures was gradually replaced by competition enforcement, as the tariff wall became increasingly lower. History does not seem to uphold his statement.

effects of the subsidy on foreign business transactions abroad.[38] In short, the idea of a concession that still pervades multilateral trade relations requires the lowering of the protection wall by a country be concurrently matched by a corresponding increase in market access for its exporters. Since subsidies, whether purposefully or as a sideline effect, lower the trade wall without paying for it, as shown above, countervailing measures rebuild the fence by way of an extra duty offsetting the amount of the grant.[39]

The early stage of GATT indirectly support this interpretation. For instance, a GATT working party in 1955 agreed that subsidies "which might affect the practical effects of tariff concessions" could be the subject of negotiation in tariffs and trade Rounds.[40] Likewise, the working party that entertained the Australian Subsidy case, which concerned the effect on tariff concessions of the repeal of a subsidy on imported goods previously granted by the Australian authorities, concluded – though with reference to disparity in domestic subsidy treatment - that the change in the Australian subsidy policy did create a situation of "non violation nullification and impairment", agreeing, therefore, with the Chilean claim that the new subsidy policy "annuls or seriously threatens" the tariff concession received by Chile.[41]

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[38] David McPherson, "Is the North America Free Trade Agreement Entitled to an Economically Rational Countervailing Duty Scheme?", *B. U.L.R.* 73 (1993), p. 54.

[39] During the Doha Round, in its "basic concepts and principles of the trade remedy rules" Communication (TN/RL/W/27, 22 October 2002), the United States with reference to the role of subsidies in the context of concessions granted during multilateral trade negotiations stated: "Those negotiations set the balance of rights and obligations among the Contracting Parties and defined the Parties' reasonable expectation of market access. At the same time, the Contracting Parties established a wide variety of rules to ensure that the balance struck would not be nullified.... In the case of trade remedies, the Contracting Parties expressly provided for the application of trade remedies to ensure that neither government subsidy practices nor subsidies upset the balance struck at the negotiating table".

[40] GATT,3rd Supp. BISD para 13, p.224,225

[41] The Australian Subsidy on Ammonium Sulphate, Report Adopted by the Contracting Parties on 2nd. 3rd.April 1950 (GATT/CP.4/39). 2 BISD, 188

**3) The institutional pattern of US trade policy and the place of countervailing procedures in the new world trade regime.**

The fact that countervailing measures are not designed to secure a level playing field, and even less to protect the maximisation of international wealth, but are only suitable for reconstructing trade barriers, raises the question of whether they can be exploited for protectionist ends. Indeed, it has consistently been argued that the United States has increasingly adopted a protectionist stance in trade policy and that one of its main tools has been "administrative protection". Certainly we cannot overlook the question of whether protectionist pressure from interest groups has an impact, if any, on trade legislation and in particular on subsidy and countervailing duties rules. What is immediately relevant, however, is to decide whether changes in the domestic and international institutional context have affected US trade policy and its countervailing duty regime in particular, and how these institutional changes are brought about. In this context institutions are to be viewed not just as political or administrative bodies but include "formal rules, compliance procedures and customary practices that structure the relationship between individuals in polity and economy"[42]

Thelen and Steinmo identify four distinct sources of institutional dynamism. Firstly, changes in the socio-economic and political context can produce a situation in which previously latent institutions become relevant. Secondly, old institutions can be used for different ends, and thirdly exogenous changes can produce a shift in the goals or strategies being pursued within existing institutions. Finally, a more radical source of dynamism occurs when political actors adjust their actions to accommodate changes in the institution

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The Case is also reported in Robert Hudec, *The GATT Legal system and World Trade Diplomacy* (New York, Washington: Praeger Publishers, 1975), p. 144.

[42] Peter A. Hall, "The Movement from Keynesianism to Monetarism: Institutional Analysis and British Economic policy in the 1970s", in Sven Steinmo et al. (eds.) *Structuring Policy. Historical Institutionalism in Comparative Analysis* (Cambridge:Cambridge University Press, 1992), p. 96.

themselves[43]. Domestic institutional changes, however, are increasingly influenced by concurrent developments in the international regimes, that is, "the set of implicit or explicit principles, norms, rules and decision-making procedures around which players' expectations converge in a given area of international relations".[44] Indeed, it is arguable that the transformation that has taken place in the multilateral trade regime over the last ten years with the establishment of the WTO are bound to constrain and at the same time shape the institutional backstage of US trade policy as well as that of other member countries.

Focusing first on the US domestic institutional developments, it appears that an assessment can be conducted on two levels: The general US trade policy and the institutional context in which countervailing measures are implemented.

The institutional setting has witnessed no radical formal change in the distribution of powers between the two main agents, Congress and the Executive. Article 1, section 8, clause 3 of the Constitution still confers upon Congress the power to regulate commerce. Since the 1930s there has been, however, a trend towards the delegation of authority from Congress to the President[45]. The bestowal of power, always limited in time, followed the disastrous experience of the Tariff Act of 1930, better known as the Smoot–Hawley Act, which increased the average rate of duties from 38.5% to 52,6%, triggering global retaliation and thereby exacerbating, the impending economic recession. The Tariff Act of 1930 aimed at providing greater protection to the US economy as a whole but the original approach was overrun by logrolling among congressmen under the pressure of a multitude of lobbies.

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[43] Kathleen Thelen and Sven Steinmo, "Historical Institutionalism in Comparative Politics", in Sven Steinmo et al., op.cit., p. 16.

[44] See Robert O.Keohane, *After Hegemony. Cooperation and Discord in the World Political Economy* (Princeton: Princeton University Press, 1984), p. 57.

The Reciprocal Trade Agreements Act of 1934 gave the President not only the authority to negotiate tariff reductions but, even more importantly, the authority to implement them without further legislative action by Congress as long as the rate cuts did not exceed the level determined by the latter. This authority was exercised at first in bilateral trade agreements, but later extended to multilateral agreements: for example, the General Agreement on Tariffs and Trade is an executive agreement. This wide delegation of power in trade affairs has entailed a bias towards liberalism as the Executive is less susceptible to pressure and more likely to consider broader national interests. In this context, the establishment in 1964 of the Special Trade Representative, now the US Trade Representative, to deal with trade matters reporting directly to the President is viewed as an attempt by Congress to insulate itself further from pressure groups.[46] It seems, therefore, that even without a formal abdication of power, exogenous changes, which can be identified first with the bitter lesson of the 1930s and with the commitments imposed upon the US by the newly acquired role of economic and political hegemon in the aftermath of World War II, have produced a shift in the strategies pursued within existing American institutions, which in turn impacts on the balance of power between the main political players.

The so-called Fast Track, presently renamed as Trade Promotion Authority, has been considered a qualitative leap in this process. In particular, the procedure provides that bills approving and implementing multilateral trade agreements may not be amended, setting strict time limits for their scrutiny by the competent Committees and for the vote on each House floor. On the other hand,

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[45] In 1934 Congress authorised the President to negotiate trade agreements with other countries and granted him the authority to reduce duties by as much as 50 per cent on a reciprocal basis. Subsequently this authority was periodically extended.
[46] J.H. Destler, *American Trade Policy* (Washington D.C. Institute for International Economics, 1995) p.14-16

the executive branch is requested to consult with Congress before signing an agreement, and the signing of the agreement must take place before the statutory deadline for the fast track to be available for the adoption of the implementing legislation.[47]

The trend, however, is not a straight one. From 1994 to 2002 Congress refused to grant the President trade authority. What is more relevant is that the granting of such authority has often been accompanied by clauses that restrict presidential leeway in implementing a liberal policy. Starting with the Trade Act of 1974, US lawmakers have taken care to include provisions that confine "Presidential Executive Agreements" to tariff barrier negotiations, securing their final control over matters that affect states' autonomy in the economic realm more deeply. Thus, taking into account that since the Tokyo Round the focus of multilateral negotiations has moved from tariff reduction to non- tariff barriers, it seems that, although the executive branch has increased its room for manoeuvring in international negotiations, overall its institutional autonomy has not been enhanced. Concurrently Congress has reinforced the automatism of those remedies that are available to domestic private interests that are affected by foreign competition, whether considered fair or unfair. In short, the US legislative power has traded off the removal of the threat of paralysing amendments in the phase of ratification, which undermined the power of the Executive branch in trade negotiations, with a set of measures that limit its discretion in providing protection to those domestic industries that cannot withstand the brunt of foreign competitors and would otherwise appeal for defence to their representatives in Congress. Three trade regimes have been affected by these changes: the relief

[47] John Jackson et Al., Legal Problems of International Economic Relations. *Cases, Materials and Text on the National and International Regulation of Transnational Economic Relations* (St Paul:West Group, 2002), p. 86.

from injury caused by import competition, known as the escape clause; the unfair trade provisions: and the antidumping and countervailing duty proceedings.

The Trade Act of 1974 tried to make protection easier to obtain for import competing industries by modifying the provision of the Trade Expansion Act of 1962 which required industries petitioning for the escape clause to prove that the "major" cause of injury was an increase in imports due to US concessions. The requirement was downgraded to "substantial" cause of injury, which is defined as "a cause which is important and not less than any other cause"[48].

Likewise, what is now section 301 of the 1974 Trade Act was originally a much more flexible and open-ended mechanism to resolve trade disputes under section 252 of the Trade Expansion Act of 1962. In 1974, when the fast track was introduced for the first time, Congress strengthened the authority of the President in identifying and opposing unjustifiable, discriminatory, or unreasonable foreign practices, but since 1979 onwards any fast track renewal has rendered the investigation procedure and its outcome less flexible and has made the executive branch more accountable to lawmakers. Thus, the 1979 Act introduced a formal investigation requirement which must result in a determination and a recommendation for presidential action within specific time limits. The 1984 Act required the presentation of an annual national trade estimate on significant barriers to the export of US goods and services. The 1988 Trade Act transferred the authority to determine whether foreign practices fall within the provisions of section 301 and to decide on the appropriate kind of action from the President to the USTR, even though this would be "subject to direction, if any, from the President", thus making the response to foreign practices less influenced by concerns other than trade interest. Although the 1988 Act maintained the

Executive's discretion in deciding whether to initiate an investigation, it limited its autonomy as to the outcome of the investigation by requiring mandatory action in the case of violation of trade agreements or unjustifiable acts.[49] Finally, under the 1988 Trade Act, the USTR was required to identify "unfair" trade practices and the countries engaged in such practises, reporting to Congress by the end of May of each year. The Trade Representative was then to initiate an investigation within 21 days of the report, and to start negotiations with the designated countries to achieve the repeal of those practices.

Accusations of protectionism have particularly been directed against unfair trade remedies, i.e. antidumping and countervailing duty as these procedures have taken over the safeguard clause as the means of protection preferred by domestic industries, becoming, in the words of Kruger, "the protectionist instrument of choice"[50]. The accusation is grounded on the fact that the legal criteria that inform these proceedings are biased in favour of domestic producers as they sanction practices that do not fall foul when domestic competition is concerned. For instance, competition rules do not prevent sales below the average cost if the price covers variable costs, nor do they prevent the granting of incentives, either financial or fiscal, to attract investment inflows. A second factor that attracted the attention of those who consider antidumping and countervailing measures as protectionist is their indefinite length once such measures are imposed by the administrative authority, whereas an escape clause can be implemented for limited

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[48] Ibid., p. 143. The modified provision is still present in the Trade Act of 1974 as subsequently amended, under sec. 202(b)(1)(B).
[49] See Julia C. Bliss, The Amendment of section 301. An Overview and Suggested Strategies for Foreign Response, Law *&Pol. Int'l. Bus.* 20 (1988), p.504
[50] Anne O.Kruger, op.cit., p. 34
Also I.M. Destler, op.cit., p. 154 et seq.

periods. This argument, however, has lost some weight due to the mandatory provision of a sunset review to extend the applicability of such measures[51].

Therefore, it has been contended that, though the "legal objective" of antidumping and countervailing duties is distinct from that of safeguards, their "economic objective", that is, protection from foreign competition through import restrictions, is the same. The protection they afford can, therefore, attract firms beset by unfair competition as well as those that simply are at a disadvantage in the race with foreign competitors. But, whereas the enactment of an escape clause is finally within the Executive's discretion, which must take into account a plurality of often competing interests, the quasi-judicial feature of the procedures in question ensures a binding result in case of positive findings[52]. According to some critics, the likelihood of positive findings was increased by changes in the institutional setting. For instance, in 1980 the assessment of both the existence and the amount of dumping and subsidisation was withdrawn from the Department of Treasury, considered to be not responsive enough to the interests of domestic industries and transferred to the Department of Commerce. It is consequently argued that due to the foregoing features, antidumping and countervailing measures afford a less costly remedy to domestic industries and above all a remedy that does not attract the attention of competing interest groups. They are, therefore, viewed as "functionally the poor (or small) man's escape clause".[53]

The criticisms of economists and political scientists is shared by prominent lawyers, such as John Barcelo who points to the weakness in the injury test, the expedited procedure, the availability of provisional remedies and the reduced discretion of the administering agency as factors that are likely to result in

[51] Agreement on Implementation of Art. VI of the General Agreement on Tariffs and Trade,1994, art 11.3. Agreement on Subsidies and Countervailing Measures, art. 21.3

antidumping and countervailing duty procedures which are biased towards protectionism.[54] Indeed, the 1979 Act introduced a stricter timetable for the assessment of subsidy and injury and for the adoption of countervailing duties, and definitely deprived the Executive of the right to apply waivers. Others, however, have defended not only the political advisability of antidumping and countervailing duties as a suitable means of preventing Congressional moves to provide trade distorting compensation to affected domestic industries but also they have defended their economic and legal rationale.[55]

Actually, the argument put forward by those indicting antidumping and countervailing measures of protectionism proves less than it would seem. Certainly, it shows that such measures are more attractive to domestic industries than safeguards; it shows that firms besieged by unfair competitors can be helped as can firms that simply do not perform well; it does not show that they aim at providing indiscriminate protection. After all, the criticisms give no proof that dumping and subsidisation are illegitimate from an economic viewpoint, and certainly domestic industries would usually be better off if they were not obliged to compete with foreign firms that dump or receive public grants. It can be argued that the protection of non-competitive domestic firms is just a by-product of the reasonable defence afforded to well performing industries. It is just a question of adjusting the net, not of abandoning it. In short, the accusation that the overall picture points to protectionism is rather controversial. Instead, as will be shown in later chapters, criticisms of the US regime are well grounded when they point out

[52] J.M. Finger et Al, "The Political Economy of Administered Protection", *The American Economic Review,* 72 (1982) n. 3, p. 455.
[53] Ibid.,p. 465.
[54] John J.Barcelo'III, "Subsidies, Countervailing Duties and Antidumping" after the Tokyo Round", *Cornell International Law Journal* 13 (1980), p. 270
[55] For a defence of US antidumping measures see Terence P Stewart,"Administration of Antidumping Law: A Different Perspective", In Richard Boltuck et al., eds, *Down,* op.cit., p. 288 et seq.

that some specific rules or their implementation by the administering authorities can run foul of economic logic and multilateral commitments and can therefore be exploited for protectionist purposes.

On the other hand, the transformation that has taken place at a multilateral level counteracts the bias towards protectionism inherent in domestic institutions. Two elements of salience have emerged in the Uruguay Round. Firstly, a more precise concept of what constitutes subsidy, and in particular prohibited subsidy has been set forth, which limits a state's leeway in applying countervailing measures. Secondly, the legal and political pressure stemming from the establishment of a new dispute settlement system that has replaced the consensus principle both for the establishment of a panel and the adoption of a WTO report with that of the negative consensus to block either of these stages.

Certainly, contrary to other international tribunal proceedings, the Dispute Settlement Understanding (DSU) is rather ambiguous over the issue of the international legal obligation to follow the determinations of the panel or the Appellate Body. Withdrawal of the measure concerned is usually required and in addition the panel and Appellate Body may suggest ways in which the member could implement the recommendation. However, if compliance is not achieved within a reasonable period of time, the defaulting member can offer compensation, and if no satisfactory compensation can be agreed upon, the prevailing member can request authorisation to take countervailing measures.. Some scholars, therefore, have argued that "compliance with the WTO, as interpreted through dispute settlement panels remains elective", since the only factor that really matters is the balance of benefits and burdens achieved among members through negotiation.[56] This approach would result in the possibility of maintaining protectionist measures that are not found to be in conformity with WTO provisions as long as the balance of benefits is preserved. Such a "realist" approach, however, puts economically weak countries at a disadvantage vis-a'-vis a strong non-compliant, especially with regard to the suspension of concessions, as the balance of interests is tilted in favour of countries with greater weight in the international economy and whose bargaining power is correspondingly greater. Others point to a set of articles in the DSU, which taken in context seem to imply an obligation to conform to the report in case of violation of the WTO Agreement and any of its components. Thus, article 21.1 provides for "compliance with recommendations or rulings of the Dispute Settlement Body in order to ensure the effective resolution of disputes to the benefit of all members", while art. 22 states that "neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation".[57]

However, as far as subsidy and countervailing measures are concerned this optimistic outlook, based on a legalistic interpretation of the WTO texts, is not entirely borne out by the ugly facts of international trade relations. In quite a few cases WTO member states (and not only the US) have implemented the reports in ways that still preserve the underlying objectives of those measures declared inconsistent with WTO rules, thus triggering a series of DSU art. 21.5 (non-compliance) disputes. In some instances, as the FSC/ETI case illustrates, the partial repeal of the measure has been due more to a wide ranging overhaul of the concerned regime for domestic reasons than to prompt compliance with the

[56] Judith.H.Bello, "The WTO Dispute Settlement Understanding:Less is More", *AJIL* 90 (1996), p. 417

[57] See John H. Jackson, "The WTO Dispute Settlement Understanding - Misunderstandings on the Nature of the Legal Obligation, *AJIL* 91 (1997), p. 63.

recommendations of the panels and of the Appellate Body. Finally, in other cases WTO members have simply ignored the decisions of the Dispute Settlement Body. The issue is made more complex by the fact that subsidies and CV measures are not confined to programmes under the direct control of the Executive, but involve statutes and lawmakers. If governments, aware of the risk of backlash for not playing by the rules of the game, have political self-interest in the preservation of the multilateral system, public choice theory attitudes still hold sway in determining lawmakers' decisions. As we shall see in many cases involving the US, we can find strong resistance to compliance, both with regard to subsidies and countervailing duties, when compliance implies the repeal of rules that favour influential interest groups.

**Conclusion**

The foregoing reflections allow for a first tentative judgement which can provide the basis for a better understanding of the legal analysis in the following chapters. There are more caveats than firm rules, but just because of this we can draw a lesson: to mistrust clear cut conclusions, as the nature of subsidies and countering measures is much more complex than appears at first sight.

The question whether countervailing measures per se are protectionist can be answered stating that they are not more protectionist than the duties whose effect they aim to preserve. Rather, the protectionist bias stems from the different weight domestic producers, foreign exporters and authorities have in the proceeding and from an identification and assessment of subsidising measures which often is not consistent with economic analysis and sometimes, as shown in

Also, Geert A. Zonnekeyn, "The Bed Linen Case and its Aftermath. Some Comments on the European Community's 'World Trade Organization Enabling Regulation'", J.W.T. 36(2002), n.5, p.997.

later chapters, with international commitments. Domestic proceedings, however, are more and more constrained by the emerging multilateral institutional setting, which provides common principles for circumscribing government actions that constitute countervailable subsidies, while at the same times making it easier to obtain the repeal of such actions through a multilateral dispute settlement procedure.

On the other hand, subsidies do not always have the same impact on international competition and can have, at least indirectly, a beneficial effect for importing countries, thus prompting non-uniform reactions.[58] In particular, the United States is not as hostile to subsidisation as might seem at first sight, and its decision to countervail and the modulation of countervailing investigations do not follow a one track pattern but are influenced by contingent factors.

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[58] Supra note 18.

# CHAPTER II

## THE MULTILATERAL REGULATION OF SUBSIDIES AND COUNTERVAILING MEASURES PRIOR TO THE URUGUAY ROUND SCM AGREEMENT

### Introduction

Fragmented and limited in scope as it was, the subsidy and countervailing measures multilateral discipline in the period from 1947 to the Uruguay Round shows a clear trend towards more stringent rules and a widening of their scope.

In principle the US supported the establishment of a trading system that would strengthen the free play of market forces and reduce the influence of government on economic affairs. In particular, the United States set its sights on export subsidies viewed as trade disruptive. Other countries, including Britain, gave priority to such objectives as full employment and external payment balance and asserted the legitimacy of governmental support to domestic industries. On the other hand, the United States had difficulties with any proposals to govern subsidies on primary products as its legislation provided lavish price and income support to its farmers, joined later by export support for American produce.

Thus the discipline of subsidies and countervailing measures set by GATT 1947 relied on two articles, whose links, at least at the outset, were far from clear, except for the fact that countervailing measures under Art.VI were directed to subsidised products, which were also addressed by the quite vague rules in Art. XVI.

Art. VI of the General Agreement acknowledged the right of any Contracting Party to impose countervailing duties, described as extra duties levied to offset any bounty or subsidy bestowed directly or indirectly, subject to two basic constraints: countervailing duties must not exceed the estimated direct or indirect subsidy on the manufacture, production or export of a commodity and they may not be levied until the importing country has determined that the subsidisation causes or threatens to cause material injury to a domestic industry, or materially retards the establishment of a domestic industry.[1] The Article provided no definition of what a subsidy or bounty is nor did it give any clue as to how to assess it. It was also silent on the nature of material injury. On the other hand, Art. XVI just provided for notification of subsidies that could affect either exports or imports and provided for discussions on the possibility of limiting the subsidisation whenever the subsidy in question could cause or threaten serious prejudice, a factor whose features were not defined. Later the article was expanded to include a more specific provision on export subsidies, distinguishing, however, between primary and non-primary products. As regards the former the Agreement required its Parties to avoid the use of subsidies resulting in the acquisition of a more than equitable share of the world market for the subsidised product, whereas for the latter it prohibited the use of subsidies resulting in export sales at prices below those charged for the like product in the domestic market.

By the early seventies, however, the United States had pressed for stricter rules for agricultural subsidies, more in line with the regulation of subsidies on non-primary products, and for the extension of the discipline to domestic subsidies.

Within this trend, the period under review witnessed the emergence of some discrepancies in the multilateral regime, which "de facto" favoured certain countries to the detriment of others. Of particular concern for the US was the impact of different tax regimes on the implementation of the multilateral subsidy

[1] The United States was exempted from complying with the material injury test under the Protocol of Provisional Application, as section 303 of the Tariff Act of 1930, which did not provide for this

and CVD regime. The US tax system burdened prevalently the factors of production through income and corporation tax, whereas the European countries taxed more heavily production and trade of goods. As the GATT allows only the exemption or deduction of indirect taxes, the United States tried to obtain a regime that equated for subsidisation purposes direct and indirect taxation. Later the United States focused on alleged disparities in the taxation of corporate income, complaining that the income tax regime of some EC member states gave to their exporters some advantages relative to their US trading partners. With regard to export financing an arrangement had been agreed on officially supported export credits under the aegis of the Organization for Economic Cooperation and Development. Here the United States had an interest in creating a link between the rules worked out within the General Agreement and the Paris Organisation in both of which it played a dominant role.

The following sections, therefore, outline the evolution of the multilateral regime on subsidies and countervailing measures prior to the Uruguay Round, but concentrate on those issues that would have an impact on the future course of the negotiations and were destined to be at the centre of important disputes related to the WTO discipline.

**1)Art. VI and Art.XVI of GATT 1947**

Despite its loopholes and its ambivalence the first text of Art. XVI of the General Agreement on Tariffs and Trade was the result of lengthy discussions leading up to the negotiations on the foundation of an International Trade Organization (ITO).

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test, antedated the GATT.

According to O'Cleireacain, the historical roots of the articles can be traced back to the American Commercial Policy Proposal of late 1945 which, in turn, to obtain the support of the other main partner in shaping the new world economic order, reflected the work of a British inter-departmental Committee on post-war commercial policy, the Overton Committee.[2] In particular, the American proposal provided for the notification of any subsidy which operates to increase exports or reduce imports, and for consultation on possible limitation of the quantity of the product subsidised, in case of serious injury to international trade. It also prohibited export subsidies (either on primary or non- primary products) which result in a sale at a price lower than the comparative one in the domestic market.[3]

The provision concerning the ban on export subsidies was not included in the GATT draft, being left to the more encompassing International Trade Organization Draft Agreement (the Havana Charter). The original text of GATT Art XVI, therefore, provided only for a reporting requirement and for consultations. The limited scope of GATT Art. XVI entailed, therefore, a rift with the provision of Art. VI which in its turn was silent on the question of which subsidy can be countervailed. The result was that any decision on imposing countervailing measures was left to the importing countries, irrespective of the nature of the subsidy to be offset. On the other hand, subsidies could be challenged under GATT Art. XXIII as measures causing nullification or impairment of a benefit accruing directly or indirectly under the General Agreement, and under GATT Art. III regarding national treatment.[4]

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[2] Seamus O'Cleireacain "Towards a Code on Subsidy and Countervailing Duties". *World Economy* 1 (1977-78),p.438..

[3] "Proposal for Expansion of World Trade and Employment – for Consideration by an International Conference". *US Department of State Bulletin*, 13 (July-December 1945), p.913.

[4] Early examples are provided by

The discrepancy became more pronounced when, after it was certain that the ITO would not be ratified by the US Congress, the Review Conference in 1955 added a section B to Art. XVI which was concerned with export subsidies, distinguishing, however, export subsidies on primary products (paragraph 3) and export subsidies on non-primary products (paragraph 4). The former subsidies were simply subject to a vague requirement that the Contracting Parties "should seek to avoid" to grant them and shall not apply them so as to get "more than an equitable share of world export trade in that product", whereas the latter were banned if they resulted in export prices lower than the price charged for the like product to buyers in the domestic market. The deadline for the prohibition was originally set on 1 January 1958 but was extended. A Declaration giving effect to the provision of Article XVI:4 was eventually adopted on 19 November 1960, providing, however, for its entry into force only with reference to those governments that had accepted it and following acceptance by the more developed European Contracting Parties, the United States and Canada. The developing countries did not accede to the declaration, and, therefore, were not bound to the ban on non-primary products' export subsidies.[5] Thus, in the period that preceded the closure of the Tokyo Round, the main difficulty that confronted the contracting parties was the identification of what constitutes export subsidy, along with the identification of "equitable share" and "previous representative period" with specific regard to primary products

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1)The Australian Subsidy on Ammonium Sulphate, Report Adopted by the Contracting Parties on 2[nd]. 3[rd].April 1950 (GATT/CP.4/39), 2 BISD, 188.
2)Italian Discrimination against Imported Agricultural Machinery, Report Adopted by the Contracting Parties on 23 October 1958 ( l/833), 7[th] Supp..BISD, 60
3)Better known to the public is the more recent "*oil-seed dispute*" between the US and the EC. Payments and Subsidies paid to Processors and Producers of Oilseeds and Related Animal Feed Proteins. Report by the Panel adopted on 25 January 1990 (L/6627), 37[th] Supp. BISD, 86. Follow-up on the Panel Report of the Members of the Original Oilseed Panel (DS28/R),. 39[th] Supp.BISD,p.91.
[5] See John H Jackson, *World Trade and the Law of GATT. A Legal Analysis of the General Agreement* (Indianapolis: Bobbs-Merrill, 1969), p. 375

*1)primary products*

The separate regime for primary products responded to the desire of a number of agricultural commodities exporting countries, especially the United States, to secure their existing practices in support of growers.[6] Phegan comparing par. 3 of GATT Art. XVI and the corresponding provisions of the Havana Charter argues that the ambiguity pervading the GATT regime for primary products results from the lack of a clear place within the general export subsidies framework. The Havana Charter envisaged a general ban for export subsidies. On the other hand, by exempting domestic price stabilisation schemes and encouraging the negotiations of commodity agreements secured special treatment for primary products, while a separate article provided for the overriding obligation not to apply any form of subsidies which operate to maintain or acquire "more than an equitable share". The obligation not to exceed the "equitable share" was, therefore, "just one aspect of an extensive set of obligation concerning export subsidies".[7] On the contrary, the 1955 addition to GATT Art. XVI prevented subsidies only if they resulted in "more than an equitable share", thus making the result, rather than the alleged purpose, the yardstick of a contracting party's obligation, At any rate the likely effect of paragraph 3 was to render the assessment of any causal link between subsidisation and acquisition of a "more than equitable share" particularly difficult, as is borne out by the overwhelming majority of Panel and Working Group reports that have dealt with this problem. The ambiguity of the text opened the door to a series of contrasting decisions and

[6] Note Ad Art. XVI, section B provided that "a primary product is understood to be any product of farm, forest, or fishery, or any mineral, in its natural form or which has undergone only such processing as it is customarily required to prepare it for marketing in substantial volume in international trade.
The Tokyo Round Subsidy Code excluded minerals from the scope of primary products.
[7] See Colin Phegan, "GATT Art. XVI:3:Export Subsidies and Equitable Shares", *J.W.T.L.* 16(1982),p. 252

was not destined to find a satisfactory solution in the provisions of the Tokyo Round Subsidies Code addressing subsidisation of primary products.

*2) non- primary products*

A conspicuous difficulty with paragraph 4 of GATT Art. XVI was that it shed no light on the variety of banned export subsidies. Actually, Art. XVI, as it stood in 1955, limited itself to giving some hints as to what does not constitute a subsidy. An interpretative note to the original section of the article excluded from the set of subsidising measures the exemption of exported products from duties and taxes borne by like products when destined for domestic consumption or the remission of such duties or taxes "in amounts not in excess of those that have accrued". Likewise, a note to Art. XVI, section B stated that nothing should preclude the use by a Contracting Party of a multiple rate of exchange in accordance with the articles of Agreement of the International Monetary Fund.

However, the Working Party report adopted on 19 November 1960 (which became the basis of the eventual Code on Subsidies and Countervailing Duties' illustrative list of export subsidies) itemised measures which should considered a form of export subsidies, emphasising, nevertheless, that the list should not be considered exhaustive.[8]

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[8] Report adopted on 19th.November 1960. 9th Supp. BISD, p. 185
The list itemised:
a) currency retention schemes or any similar practices that involve a bonus on exports or re-exports;
b) the provision by governments of direct subsidies to exporters;
c) the remission, calculated in relation to exports, of direct taxes or social welfare charges on industrial or commercial enterprises;
d) the exemption, in respect of exported goods, of charges or taxes, other than charges in connection with importation or indirect taxes levied at one or several stages on the same goods if sold for internal consumption; or the payment, in respect of exported goods, of amounts exceeding those effectively levied at one or several stages on these goods in the form of indirect taxes or of charges in connection with the importation or in both forms.
e) in respect of deliveries by governments or governmental agencies of imported raw materials for export business, the charging of prices below world prices;
f)in respect of government exports credit guarantees, the charging of premiums which are manifestly inadequate to cover the long-term operating costs and losses of the credit insurance institutions;

A further difficulty of the GATT text stemmed from the dual price condition for the right to impose countervailing duties in Article VI. The provision, which oddly equated subsidisation with dumping, relied on the assumption that the cost reduction must be passed on to consumers to gain a competitive edge. The dual price test, however, proved unworkable for two reasons: firstly, because in a less than perfectly competitive market subsidy programmes may not result in a lower export price, being utilised to improve the cash-flow position of a firm or to encourage economies of scale, thus increasing in the long run its export capacity; secondly, because production statistics are seldom available for a detailed comparison between domestic and export prices.[9]

Border tax adjustment was the main cause of conflict in the GATT forum, where the United States urged equal treatment for direct and indirect taxation, as well as of potential divergence between US domestic rules and multilateral provisions.[10] The United States did not have a corresponding provision to those of GATT Art. XVI:4 and note Ad Art. XVI, but the Treasury Department, which was the administering authority until 1980, had constantly limited the imposition of countervailing duties to the remission of indirect domestic taxes in excess of the amount of tax paid or otherwise due. This administrative practice was contested by a US firm in a case concerning the exemption or remission upon exportation from Japan of a single stage consumption tax, usually levied at manufacturing level on electronic goods. The case went up to the Supreme Court, which upheld the Department's negative ruling on the petition for countervailing

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g) the grant by governments (or special institutions controlled by governments) of export credits at rates below those which they have to pay in order to obtain the funds so employed;
h) the government bearing all or part of the cost incurred by exporters in obtaining credit.

[9] See Gary Clyde Hufbauer and Johanna Shelton Erb, *Subsidies in International Trade* (Washington DC:Institute for International Economics, 1984), p. 47

[10] An overview of the main points at stake in the negotiations on border tax adjustment is provided by the Report of the Working Party adopted on 2 December 1970 (L3464). 18th BISD, p. 97

duties, in what seems to be a highly political decision.[11] The Supreme Court, which contradicted the broad construction of sect. 303 of the 1930 Trade Act applied by earlier decisions without explicitly overruling them, predicated its decision on five factors. First, the legislative history of the statutes on countervailing measures since the Tariff Act of 1930, which, in its opinion, overall appears to confirm that lawmakers did not intend that duties were to be "assessed where the "bounty" does not exceed the amount of taxes already paid". Second, the fact that the Treasury Department had maintained its statutory interpretation for over 80 years since the very onset of the legislation concerned. Third, the fact that, also in light of the legislative history, this interpretation is reasonable and as such must be upheld by reviewing courts. Fourth, the incorporation of the US administrative position into the General Agreement on Tariffs and Trade and, therefore, the establishment of "foreign tax systems as well as private expectations on the assumption that countervailing duties would not be imposed on non-excessive remission of indirect taxes" in the United States. Finally, the Supreme Court, distinguished *Zenith* from its first decision on border tax adjustment, *Downs v. United States*, noting that the grant involved in Downs was not the remitted tax but the certificates issued by the Russian government to sugar exporters.[12]

The decision, however, attracted doubts and criticisms from a strictly legal angle. The criticisms focused prevalently on two aspects: the Supreme Court had failed to distinguish *Zenith* from other previous cases, such as *Nicholas* which had followed a broader construction of bounty and grant, which, apparently, encompassed indirect tax refund;[13] the decision had not taken into account that the GATT, having been implemented in the United States by an executive agreement,

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[11] Zenith Radio Corp. v United States, U.S.S.C. Rep. 437 U.S. 443 (1978).
[12] Robert E.Downs v United States, U.S.S.C. Rep. 187 U.S. 496 (1903).

cannot prevail over contrasting US statutes as they are constructed, in a common law system, by the courts.[14]

The decision, though controversial, marked, at any rate, the definite falling into line of the United States' legislation with the provision of GATT. On the other hand, the United States pressed for the amendment of GATT Art. VI:4 and note Ad Art XVI to obtain equal treatment for direct taxes. The above-mentioned provisions are based on the partial adoption of the destination principle whereby sales taxes are collected by the country in which goods are consumed. Not permitting exemption or remission of taxes or duties already paid would, therefore, result in a double tax burden on exported goods. However, as they refer to taxes and duties on products, they leave aside those on factors of production, which are subject to direct taxation.[15]

The system favoured the EC member states whose main share of tax receipts was provided by indirect taxes. On the contrary, the United States relied mostly on direct taxation. The US contended, therefore, that the GATT regime caused disparity among different forms of taxation, as it was inconsistent with economic analysis being based on the false premise that only indirect taxes are shifted to consumers, whereas direct as well as indirect taxes can be shifted either

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[13] Nicholas (G.S) & Co. v United States, U.S.S.C. Rep. 249 U.S. 34 (1919)..

[14] For a rather critical analysis of Zenith see Robert D. Arkin, "The Countervailing Duty Law after Zenith. Unanimity can be Beguiling", *Va.J.Int'l.L.* 18 (1978) n. 2, p. 245.

Another critical assessment – with reference to the 1977 decision of the US Court of Customs and Patent Appeals (C.C.P.A. July 28, 1977) upheld by the Supreme Court - is provided by Craig M. Brown, " "Bounty or Grant". A Call for Redefinition in Light of the Zenith Decision" *Law &Pol'Y Int'l Bus.* 9 (1977),p. 1229

[15] See Melvin B. Krauss, "Border Tax Adjustments: A Potential Trans-Atlantic Trade Dispute", *J.W.T.L.* 10 *(1976)*, p. 145, 148

Krauss points out that taxation of export products can be based either on the "location of consumption" principle (also called destination principle) or the "location of production" principle (also called origin principle). To implement the former imports must be taxed at the same rate as domestically produced goods, while exports must leave the taxing jurisdiction tax free. To implement the latter all exports must be taxed at the same rate as domestically consumed goods, while imports must enter the taxing jurisdiction tax free as they are not produced domestically. Border Tax adjustments (BTA) based on the destination principle are neutral with respect to international trade so long as import compensatory duties and export rebates equal the tax carried by domestically produced goods.

forwards or backwards according to the interplay of factor supply and product demand.[16] The United States, however, did not succeed in obtaining equal treatment for direct taxes levied on production factors. The illustrative list of export subsidies annexed to the so called Tokyo Round Subsidies Code of 1979 confirmed the ban on the remission of direct taxes and social welfare charges.[17] On the other hand, the illustrative list of the 1979 Subsidies Code introduced a distinction with regard to exported goods which was not included in the list made out by the report adopted on November 19, 1960 and which arose from the difficulty in assessing the tax burden on some of the inputs of the exported goods. Items h) and i) of the new list distinguished between goods that are physically incorporated in the exported goods and goods that are not physically incorporated, differentiating within to the latter category between value added tax (VAT) and cumulative taxes and import charges. Cumulative indirect taxes (also known as cascade system taxes) are multi-staged taxes levied without a mechanism for subsequent crediting of the tax if the goods or services subject to taxation at one stage of production are used in a later stage. Contrary to the cascade system, the VAT, which is known as an input tax, entitles taxable persons to recover the tax incurred on acquiring goods or services in the preceding stage.[18] The "physical incorporation" principle, which has been substantially retained by the Uruguay Round Agreement on Subsidies and Countervailing Duties, permits the rebate of every kind of indirect tax and import duties on inputs that are physically incorporated in the final product, such as raw materials and intermediate products. The rebate is not allowed on so-called "taxes occultes", that is, the hidden

[16] Ibid., p.152.
Also Gary Clyde Hufbauer and Johanna Shelton Erb, *Subsidies*, op.cit., p. 51.
[17] See infra,section 2).
[18] On the EC VAT mechanism, see, in particular, Paul Farmer, Richard Lyal, *EC Tax Law* (Oxford:Clarendon, 1994) p. 161 et seq. and p. 190 et seq..
Also David W. Williams, *EC Tax Law* (London:Longman, 1998).

element of taxation that by the cascade system falls on other goods and services used in the production process. They include multi-staged taxes on capital equipment, services and such inputs as fuel and electricity.[19] VAT, on the other hand, is excluded from the physical incorporation requirement, as at each stage previously incurred taxes are recovered. For goods whose stages of production are subject to VAT, therefore, it is only a question of replacing the domestic rate of taxation applied by the exporting countries at the final stage with that applied by the importing country. Also in this case the GATT regime favoured the European Communities that since 1 January 1978 had adopted a common system of value added tax.

*3) The question of disparity in direct tax regimes*

The difficulty caused by the absence of a clear legal framework is further illustrated by the dispute over taxation of corporate income in the United States, Belgium, France and the Netherlands and its use as subsidisation. Prior to 1962 the United States did not tax the income of corporations organised outside the US until its repatriation by way of dividends. Subpart F of the Revenue Act of 1962 taxed US shareholders on the income of controlled foreign corporations in the fiscal year in which income accrues to the subsidiary, through the "fictio iuris" of considering, for fiscal purposes, such an income as distributed dividend. Very quickly, however, the United States realised that the stringent anti-avoidance provisions of Subpart F put US corporations at a disadvantage relative to their trading partners, especially those resident in some EC member states that had adopted the exemption method. Under this principle the state of residence of the

[19] Patrick Law, "The Definition of "Export Subsides" in GATT, *J.W.T.L.* 16 (1982),p. 378.
On the potential problems caused to some developing countries by the differential regime on exported goods , see Vijay Laxman Kelkar, GATT, Export Subsidies and Developing Countries, *J.W.T.L.* 14 (1980), p. 372

taxpayer does not include in the tax base those profits from activities carried out abroad (usually, but not necessarily through a permanent establishment). Besides, the EC member states in question did not tax the whole or a substantial "chunk" of the dividends distributed by foreign subsidiaries.

From an export subsidy angle the simplest thing for the US to level the playing field with its competitors would have been to repeal subpart F. But from a fiscal angle, such a solution would mean a significant curtailment of Treasury's revenues by cutting the net that allowed the imposition of undistributed foreign income directly on the US parent company. We must not forget that at that time MNCs were predominantly a US phenomenon. The solution worked out by the US Treasury was to carve out a special tax regime in favour of those companies engaging in export activities. Under the 1971 DISC legislation exporters were allowed to create domestic paper shell affiliates, known as "Domestic International Sales Corporations (DISC)", to be used as the conduit for exporting goods actually sold by the parent company. The export profits were apportioned according to various formulas between the shell company and its parent company. One half of the DISC's profits were deemed distributed back to the parent exporter, while the other half would be deferred until distribution to the parent. As intended by the American Executive, very soon tax experts and accountants understood that the deferral could be infinitely extended, thus actually coinciding with an exemption, as no interests accrued on the deferred tax. In practice, the scheme allowed a deferral/exemption on 25 percent of the exporter's total export profits, later reduced to 17-18 percent.[20]

[20] Robert E. Hudec, *Enforcing International Trade Law. The Evolution of the Modern GATT Legal System* (Butterworth Legal Publishers, 1993), p 60
Also, Thomas Kwako, "Tax Incentives for Exports, Permissible and Proscribed ? An Analysis of the Corporate Income Tax Implications of the MTA Subsidies Code", *Law & Pol'y Int'l Bus.* 12 (1980),p. 687.

After the failure of bilateral consultations, in 1973 the European Community lodged a complaint with the GATT arguing in particular, that the DISC provisions violated Art. XVI:4 of the General Agreement, with reference to items c) and d) of the 1960 illustrative list, as the regime conferred an export subsidy to US producers by allowing a continuous deferral of their foreign sale income tax liability, or in any case, by the exemption of the compound interest rate on the deferred tax.[21] The United States promptly countered arguing that the tax exemption of foreign profits led to equivalent economic distortions as it allowed European producers to reduce their overall tax liability by organising foreign branches or subsidiaries in low-tax countries and using transfer price[22]. The US accepted the creation of the panel, but on condition that a single panel should entertain the three European complaints together with the American one. It was a clever tactic, which worked in the short run. Professor Hudec, who seems rather sympathetic to the economic equivalence argument, noted that "although the European defendants convincingly denied the intent to subsidise and the occurrence of harmful economic effects, they never made a serious effort to dispute the United States' argument as such".[23] In a highly politicised report, the panel, in a Solomonian way, held that neither the DISC regime nor the territoriality principle were fully consistent with GATT Art. XVI.[24] This gave the US substantial diplomatic leeway, as the repeal of the recently adopted DISC provisions was conditional on the surrender of the long-standing territoriality approach by its EC counterparts. The argument, however, had two main flaws:

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[21] 23rdSupp. BISD. United States Tax legislation (DISC).Report of the Panel presented to the Council of Representatives on 12 November 1976 (L/4422), paras 11-12..

[22] 23rdSupp. BISD.Income Tax Practices Maintained by France, (L/4423), paras. 18-19.
23rdSupp. BISD. Income Tax Practices Maintained by Belgium, (L/4424), paras. 15-17.
23rdSupp. BISD. Income Tax Practices Maintained by the Netherlands, (L/4425), paras. 14-16.
The term "exemption method" is more appropriate but the parties to the dispute and the panel preferred the less technical term "territoriality principle"

[23] Robert E. Hudec, *Enforcing*, op.cit.,p. 84.

1) In the first place, it caused a splintering of the economic law discipline provided by multilateral regimes. From the 1963 OECD model convention against double imposition, the exemption method is one of the only two systems allowed by the Paris Organisation to avoid double taxation, the other being the tax credit method, applied with reference to the worldwide regime of taxation.[25] Therefore, we are confronted with the paradox of a tax regime recognised by the Organization for Economic Cooperation and Development - of which the US is one of the most prominent members - that becomes a prohibited subsidy under the rules of the General Agreement on Tariffs and Trade, of which the US is a party.

2) Secondly, the equivalence argument fails to notice that, notwithstanding their economic similarities, the two fiscal rules operate on quite a different legal canvas. The exemption principle was an integral part of the French, Belgian and Dutch tax systems, going as far back as the early 1900s.[26] The system was initially a criterion for the assessment of income, under which not only profits generated abroad, but also costs linked to a foreign undertaking are not taken into account to establish the corporation's tax base.[27] Thus, the method had its pros for the company but could also have its cons. For instance, a permanent establishment abroad could run high costs of production which are not offset by sales revenues, and yet such costs cannot be taken into consideration in assessing the income of the firm. Also the exemption of dividends from controlled

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[24] 23rdSupp. BISD. L/4422, paras.67-74. L/4423, paras.47-49. L/4424, paras. 32-37. L/4424, paras. 34-37.

[25] See Integrated Texts of the OECD Commentaries of the 1977 and 1992 Commentary on Articles 23A and 23B concerning the methods for the elimination of double taxation. Reprinted in *Materials on International &EC Tax Law*, selected and edited by Kees Van Raad – 2002/2003 (International Tax Center Leiden, 2002).

The Commentary states: "Under the principle of exemption state R (the state of residence the state of residence) does not tax the income which according to the convention may be taxed in state E (the state where a permanent establishment is situated) or S (the state of source or situs).

Also, Brian J. Arnold and Michael J.McIntyre. *International Tax Primer* (The Hague:Kleuwer Law International, 2002) p. 33.

[26] John H. Jackson, "The Jurisprudence of International Trade: The DISC Case in GATT", *A.J.I.L.* 72(197*8)*., p. 775.

companies was a long-standing general rule, which, at least in the case of France, extended to nationally controlled companies.[28] On the contrary, the DISC regime was just a method to exempt a quota of already determined income, which would otherwise be taxed under the anti-avoidance rules. As the exemption was linked to export revenue, it perfectly matched the provision of item ( c ) of the illustrative list of 1960.[29]

This simple truth was finally recognised by the Parties to the General Agreement. After a five year stalemate, in December 1981 the Council adopted the four reports but with the understanding that "with respect to these cases, and in general, economic processes (including transactions involving export goods) located outside the territorial limits of the exporting country need not be subject to taxation by the exporting country and should not be regarded as export activities in terms of Article XVI:4 of the general Agreement", thus implicitly acquitting the mentioned European countries' regime based on territorial principle. [30] By contrast, no acquittal could be inferred for the US DISC regime. However, by way of consolation for the United States, the Understanding also stated that "Article XVI:4 requires that arm's length prices be observed", making it, therefore, clear that territoriality was legitimate as long as it was not exploited for transfer price schemes between parent companies, and either their foreign subsidiaries or their permanent establishments.

After a last attempt to defend the legitimacy of the DISC measure in the light of the Understanding in October 1982 the US announced that it would pass legislation to correct the complaints made about the regime and two years later replaced it with a new type of tax exemption, conditional this time on the

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[27] See Lionel Halpern, *Taxes in France (Adapted from Françis Lefebvre's Les Impôts en France)* (London: Butterworths, 1980) p.11.
[28] Ibid. p.40.
[29] See note 13 supra.

establishment of a foreign subsidiary, the Foreign Sales Corporation (FSC). As we know the reform did not clear up the problem but only made its ascertainment more difficult.

**2)The Tokyo Round Subsidies Code**

The Tokyo Round negotiations had among their core topics a stricter and clearer regulation of subsidies and countervailing measures than those provided by the rather patchy set of rules described in the previous section. In spite of its ambitious goals the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT (commonly referred to as the Subsidies Code) was not an unqualified success. It had three main faults. The Code did not succeed in binding all Contracting Parties and, therefore, fostered the adoption of a plurality of regimes whose implementation was of doubtful conformity with basic GATT principles, such as the unconditional MFN clause. Secondly, it failed to provide a definition of subsidy for national countervailing duty purposes and this allowed the United States in particular to keep its leeway in applying countervailing measures[31] Thirdly, given the disagreement over the liberalisation of trade in agriculture between the US and the European Community, it failed to address the controversial question of subsidisation of primary products whether by equating their treatment to that of non-primary products or by clearly defining the causal

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[30] Tax Legislation (L/5271). 27th BISD, p. 114

[31] See John H. Jackson, *The World Trading System. Law and Policy of International Economic Relations* (Cambridge, Mass. And London: The MIT Press, 1997) p. 288.
Professor Jackson's remark seems to be grounded on the premise that the General Provisions in Art. 8 of Part II of the Code do not extend to Part. I which refers to the application of Article VI of the General agreement.
Also, Richard R. Rivers and John D. Greenwald, "The Negotiations of a Code on Subsidies and Countervailing Measures. Bridging Fundamental Policy Differences" *Law and Pol'y Int'l Buss.*, 11 (1979), p. 1463.

link between subsidising activities and acquisition of more than a fair share of the market. On the other hand, the Code provided a set of specific and stricter rules to apply domestic countervailing measures and to contrast subsidisation in multilateral fora, which paved the way to the Uruguay Round SCM Agreement.

*1) Track I and Track II*

To a certain extent the Subsidies Code satisfied the opposite aims of the US and of the majority of the other Contracting Parties. The US were pressing for stricter rules to curtail subsidies, strengthening the ban on export subsidies and attracting domestic subsidies in the regulatory framework. On the other hand, the majority of GATT Contracting Parties were concerned with restricting US freedom in applying countervailing measures. One of their main preoccupations arose from the absence of a "material" injury test in the US statutes as the United States had taken advantage of the grandfather clause not to modify its legislation on countervailing measures previous to the General Agreement.[32]

In light of the foregoing political framework, the Code envisaged two forms of remedial action, usually called Track I and Track II. Progress was especially realised with respect to procedural aspects, filling the gaps of the General Agreement by working out a detailed road map both for the imposition of countervailing duties and for the settlement of disputes. Advances, however, were also realised on the substantive side, in particular with regard to a more detailed identification of types of export subsidy and the question of injury.

For the first time in GATT history, the Code clearly stipulated the conditions under which countervailing duties may be imposed against subsidised

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Rivers and Greenwald seem to share Professor's Jackson opinion, arguing that "Art. VI and Art. XVI of GATT are conceptually unrelated. ... It makes little difference whether the subsidy in question is legal or illegal".

imports. In particular, the Code provided that a government may begin an investigation into the existence of a subsidy only when it has sufficient evidence of the likelihood that a subsidy exists, that there may be material injury to domestic industry, and that there is a causal link between the alleged subsidy and the injury to the industry. This provision was a compromise. The United States opposed a proposal to adopt the wording of the 1967 International Antidumping Code according to which subsidy would have been demonstrably the principal cause of injury. It agreed, however, on a less stringent causality requirement in Art. 6.4 of the Code providing that "subsidized imports are, through the effect of the subsidy, causing injury within the meaning of this agreement" and that "injuries caused by other factors must not be attributed to the subsidized imports".

Normally investigations were to be initiated upon written request by or on behalf of the industry affected, but in special circumstances they could be started without a request if there is sufficient evidence of injury caused by subsidised imports.[33] During the period of investigation signatory states were to be given the opportunity to consult with the state conducting the investigation. The Subsidies Code also provided for the imposition of provisional measures if after sufficient investigation a preliminary positive determination is reached that a subsidy does exist and if there is sufficient evidence of injury. Definitive countervailing duties could be imposed only after a final determination had been reached that a subsidy exists and that subsidised imports are causing or threatening material injury.[34]

As will be seen in Chapter IV, these detailed provisions were in large part reproduced by the Uruguay Agreement on Subsidies and Countervailing

[32] See John W. Evans, "Countervailing Duties in the GATT. Present Law and Future Prospects" I.T.L.J., 1977, p. 227.
[33] Article 2.
[34] Articles 3- 6.

Measures. They failed, however, to identify the exact nature of their object: subsidised exports.

On the other hand, this not minor problem was tackled by Track II which addressed the substantive obligations concerning the prevention of subsidies that affect goods in international trade and provided procedural remedies to counteract them within the multilateral framework. The substantive obligations gave substance to the provisions of GATT Art, XVI. In particular, Art. 8 of the Agreement condemned subsidies which resulted in three sorts of adverse effects: injury to the domestic industry of another signatory; nullification or impairment of the benefits accruing to another signatory under the General Agreement; and serious prejudice to the interest of another signatory. What is relevant is that, in contrast to GATT Art. XXIII, the Code subjected to dispute settlement procedure, not only the violation of an obligation under the General Agreement, that is, the ban on export subsidies under GATT Art. XVI:4, or the nullification or impairment of previous benefits, but also serious prejudice which previously only gave rise to a commitment to consult with the affected party. The Code under Art. 9 reaffirmed the ban on export subsidies, but the United States achieved limited success by bringing domestic subsidies within the framework of Track II. The US had proposed a "supplementary understanding" which included an "illustrative list of internal subsidy practices" that can have adverse effects on trade. This list was not retained, but article 11 recognised that "subsidies other than export subsidies may cause or threaten to cause…injury to a domestic industry of another signatory or serious prejudice to the interests of another signatory or may nullify or impair benefits accruing to another signatory under the General Agreement".

The Code no longer referred to the bi-level pricing criterion provided by GATT Art. XVI:4. The United States had argued that the criterion should be dropped, whereas the European Community had supported it. The absence of any reference to the bi-level price criterion in the Code has been interpreted in various ways. Hufbauer and Shelton Erb argue that the "the burden of disproving bi-level pricing has been shifted to the proponent of the practice, that is, the defendant".[35] Seyoum suggests that in cases where a signatory is using a practice not included in the illustrative list, "a complainant could only prove that a practice amounts to an export subsidy by evidencing the fact that it results in dual pricing". On the other hand, he points out that dual pricing remains a yardstick in any controversy between a signatory of the Code and any other Party of the General Agreement.[36]

In this context the Code, under Articles 12 and 13, provided for a dispute settlement mechanism governed by a Committee on Subsidies and Countervailing Measures made up of representatives of each of the countries adhering to the agreement. Any country under the Code could request consultations with the signatory thought to be granting a subsidy inconsistent with the provisions of the Code. If no solution was achieved within 30 days in the case of export subsidies and within 60 days in the case of any other subsidy, the country alleging an inconsistent subsidy could request that a panel of experts be established by the Committee with the purpose of reviewing the facts of the dispute. The panel was to be established within 30 days and had 60 days to present its findings to the Committee. The Committee could make recommendations on a solution to the dispute within 30 days of its receipt of the report. If the recommendations were not followed within a reasonable period of time, the Committee was empowered to authorise appropriate retaliatory countermeasures against the offending party.

[35] Gary C. Hufbauer and Joanna Shelton Erb, Subsidies, op. cit., p. 48.
[36] Belayneh Seyoum, "Export Subsidies under the MTN. An Analysis with particular emphasis on developing countries", *J.W.T.L.* 18 (1984), p. 516.

Special treatment was granted to developing countries.[37] This benefit, however, did not extend to the greatest item of interest to those countries that were in the course of industrialisation: the exclusion from countervailing measures regulated under Track I.[38] With regard to Track II, developing countries were only subject to quite a vague obligation not to use export subsidies in a manner which causes serious prejudice to the trade or production of another signatory. A developing country was also requested to endeavour to enter into a commitment to reduce or eliminate export subsidies when their use was "inconsistent with its competitive and developmental needs". The Code, however, did not specify at which stage of industrial development subsidisation was no longer consistent with the developing country's needs. With respect to non-export subsidies, no countermeasures were permitted (obviously under Track II) unless nullification and impairment was found to exist "in such a way as to displace or impede imports of like products into the market of the subsidizing country, or unless injury to domestic industry in the importing market of a signatory occurs"[39].

*2) Export credits and the relationship between the Code and the OECD Arrangement*

We have already referred to some of the main amendments introduced with regard to the 1960 list by the Code's illustrative list of export subsidies. One of the main changes concerns export credits.

The Report adopted on 19th November 1960, under item g) of the list considered as a form of export subsidy the grant of credits by governments or special institutions controlled by governments at interest rates below those which the latter have to pay to obtain the funds. Here the benchmark to assess the

[37] Art. 14.
[38] Belayneh Seyoum, Export, op.cit., p. 520.

existence and amount of subsidisation is the difference between the rate of interest charged by the government and the cost borne by it. Part of the subsidy, therefore, remains hidden, as government authorities are usually able to borrow at rates lower than those charged to any commercial borrower. Item h) of the list provided that subsidisation occurs when governments make up the whole or part of the costs incurred by exporters in obtaining credit.

Item ( k) of the Subsidies Code list (which unified items g and h of the 1960 list) introduced three relevant specifications. Firstly, the grant is bestowed not only when governments or governmental agencies have actually paid an interest rate higher than that charged on the export credit, but also when they would have to pay such interest if they borrowed on international capital markets to obtain funds of the same maturity and denominated in the same currency as the export credit. This addition simply acknowledges that governments and their agencies need not turn to the market as they can directly tap into their own budgets. Secondly, it specifies that both the provision of credit by government authorities and the covering by them of the cost of credit are forms of subsidisation only "in so far as they are used to secure a material advantage in the field of export credit terms". It remains to be seen what is meant by material advantage in the field of export credit. Is it merely diplomatic fog bank or does the term have -a technical meaning? This question, however, had to wait until the Uruguay Round SCM Agreement to get an answer and will therefore be examined in a subsequent chapter.[40]

Of greater relevance is the addition of a second paragraph by which the negotiators, without referring to it by name, deferred to the provisions of the

[39] Art. 14.7

[40] See in particular, Brazil - Export Financing Programme for Aircraft – AB 1999-1 – Report of the Appellate Body. WT DS46 AB R

OECD Arrangement on Guidelines for Officially Supported Export Credits.[41] The Arrangement set maturity terms and minimum interest rates for officially supported export credits. The maturity terms varied according to the per capita income of the importing countries which were divided into three categories. Minimum interest rates originally varied according to country classification and repayment terms within the so-called "matrix".[42] At a later stage Commercial Interest Reference Rates (CIRRs) for each credit currency replaced the matrix interest rates approaching the OECD discipline to the ongoing market conditions.[43]

The partial incorporation of the OECD Arrangement by the Tokyo Round Subsidies Code through this safe harbour provision created a set of problems. Firstly, the Arrangement, which, not having been submitted to the OECD Council for approval, is not an "act of the Organisation", is not intended to have legal force; rather, it is a political commitment which falls within the "soft law" class of international rules. Secondly, as the title suggests, the Arrangement did not aim at eliminating subsidisation in export financing, being instead designed to create a level playing field for export credit agencies in industrialised countries. It is, therefore, easy to argue that the safe harbour provision gave an advantage to those Subsidies Code signatories who were also parties to the Arrangement. The incorporation, however, entailed two main questions:

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[41] "Provided, however, that if a signatory is a party to an international undertaking on official export credit to which at least twelve original signatories to this Agreement are parties as of 1st. January 1979 (or a successor undertaking which has been adopted by those original signatories), or if in practice a signatory applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement".

[42] See John M. Duff Jr., "The Outlook for Official Export Credits", *Law&Pol'y Int'l Bus.* 13(1981), p. 901.

[43] For an in-depth history of the various stage of the OECD Arrangement see John E. Ray, *Managing Official Export Credit. The Quest for a Global Regime* (Washington D.C.:Institute for International Economics1995).

1) what is the scope of the safe harbour? That is, does it encompass all the provisions of the Arrangement or is it limited to a specific sector, i.e. interest rates and if so, to what extent?

2) Does the safe harbour provision extend to countervailing proceedings?

The prevailing doctrine of the period called for strict adherence to the text of item (k) which refers to interest rates, arguing that if the drafters of the Subsidies Code list had meant to incorporate the entire OECD Arrangement they would not have made explicit reference to interest rates, and that an open-handed reference to the whole Arrangement would render the safe harbour provision rather opaque.[44] There was, however, the question of defining the interest rates covered by the Arrangement. Indeed, the Arrangement on Guidelines for Officially Supported Export Credits establishes the minimum interest rates OECD members must apply but, under specific circumstances, allows them to offer rates below the minimum fixed by the general rules of the Arrangement. One of the main types of authorised waiver, matching, was the subject of a countervailing investigation conducted by the Department of Commerce in 1982. In this case a governmental export credit agency, EDC, financed the tender made by a Canadian corporation, Bombardier, for the provision of railcars to the Metropolitan Transport Authority of New York. The offered interest rate was below the OECD minimum but it matched the terms of the financial offer made by the French government to support the bid of the French competitor. The US Department of Commerce in its affirmative final determination held that, regardless of whether the Canadian agency was matching a prior commitment under the OECD Arrangement, the financial offer was in derogation of the OECD Arrangement on several points and, therefore, item (k) was not relevant. Specifically, according to

[44] Gary Clyde Hufbauer and Joanna Shelton Erb, Subsidies, op.cit., p. 72.

the Department, the item referred only to an export credit transaction which is in conformity with the minimum interest rate provisions of the Arrangement, whereas the matching provisions deal exclusively with offers that are not in conformity with the Arrangement.[45]

As to the extent of the exemption the European Community argued that so long as an export credit is within the OECD guidelines it is not a subsidy at all and, therefore, cannot be countered. In response the United States contended that, though subsidised credits which are in conformity with the OECD Arrangement cannot be countered within the Subsidies Code, they still constitute export subsidies and, therefore, can be countervailed within the domestic legislation of the signatories.[46]

In defence of the US approach de Kieffer resorted to a literal construction of item (k) of the illustrative list noting that its text states that "an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement". He, therefore, argued that the list does not say that such practices do not constitute subsidies at all, but it simply excludes them from the Code ban.[47] Frenkel and Fontheim reached a similar

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[45] Final Affirmative Countervailing Duty Determination Railcars from Canada. 48FR6569 (February 14, 1983) web.lexis-nexis.com/professional.
A summary of the case in question sheds light on the apparently esoteric concept of matching, as this concept will re-emerge in cases entertained by the Dispute Settlement Body under the WTO rules.
A Canadian company, Bombardier, negotiated with a Canadian governmental export credit agency, EDC, financing for its bid in a tender to provide railcars to the Metropolitan Transport Authority of New York. EDC offered a buying credit to the New York authority, making it clear that it was prepared to offer financing terms not less favourable than those offered by any competing governmental agency . The French government offered to provide financial assistance to the French competitor, Franco rail, with an export credit whose interest rate was 9.7%, that is below the minimum established by the OECD Arrangement at that time. The Canadian authority provided the same credit terms, i.e. matched the French loan, neutralising the prospective financial advantage of the French bid. The provision of the cars was thus awarded to Bombardier, to the great disdain of an American competitor, Budd, which promptly filed a CVD petition.
[46] Preliminary Countervailing Duty Determination Railcars from Canada. 43 FR 53760, 1983)web.lexis-nexis.com/professional.
See Donal E. de Kieffer, "The Role of Export Credits in International Trade", in John H. Jackson et al., eds., *International Trade Policy. The Lawyer's Perspective* (New York:Matthew Bender. 1986)chap. 17, p. 2
[47] Ibid., p. 2.

conclusion arguing that item k of the list does not supersede GATT Art. XVI:4 which bans export subsidies.[48]

These arguments, however, fail to note that the Subsidies Code cannot be considered apart from the General Agreement. Indeed, the Code had the ambitious title of Agreement of Interpretation and Application of Articles VI, XVI and XXIII of the General agreement on Tariffs and Trade and as such it aimed at defining the content of the above-mentioned GATT provisions. In so doing it claimed authority for entirely excluding practices in conformity with the Arrangement from the General Agreement's sanctions, though with its effect limited to the signatories.

The claim of the United States to have a right to countervail practices consistent with the OECD Arrangement would probably be valid at that time, but only if grounded on another factor. As already noted, there is no cross-flow between Track I and Track II of the Code and, therefore, it is arguable that the illustrative list refers only to export subsidies for the purposes of multilateral legal remedies without limiting the domestic legislation's response. The question, however, was never put to a panel report test when the Code was in force.

**Conclusions**

On balance, the United States succeeded in establishing, especially as a result of the Tokyo Round, a stricter regulatory framework for subsidies, closing up the loopholes it had contributed to create some thirty years earlier. The main achievements, however, referred to the procedural aspects by the establishment of a clear path to solve disputes on subsidies and imposing countervailing measures. On the other hand, the Tokyo Agreements bound few parties to the GATT, and contributed to the compartmentalisation of the General Agreement. The Subsidies

[48] Orit Frenkel and Claude G.B. Fontheim, "Export Credits. An International and Domestic Legal Analysis", *Law & Pol'y Int'lBus.* 13 (1981),p. 1079.

Code, together with the Government Procurement Agreement, is commonly considered to derogate from the unconditional MFN principle.[49] The approach adopted by the Code allowed a signatory to make its extension of trade benefits conditional on the acceptance of the Code obligations by beneficiary countries. In particular, articles 1,8,11 and 19 restricted benefits and obligations imposed by the Agreement to the signatories. In implementing the subsidies Code, section 101 of the Trade Agreements Act of 1979 applied the new US countervailing duty law providing for a material injury test only to countries that had also accepted the MTN subsidies Code, along with countries that had assumed substantially equivalent obligations with respect to the United States.[50]

At any rate, the success of the United States in shaping the non-procedural aspects of the subsidy and countervailing measure multilateral regime was far from complete. Apart from agriculture, which substantially remained outside the GATT framework, no precise link between article VI and XVI of the General Agreement was established. Domestic subsidies were brought within the framework of the General Agreement but no specific criteria were established to determine the conditions under which they could be banned and subject to countervailing duties. As regards the treatment of tax regimes for subsidy purposes the United States failed to bring to the same level direct and indirect taxation. Only the former escaped the ban on export subsidies, although only partially, whereas the latter, which was the main source of revenue for the US Treasury, was caught in the net of the prohibition. At a later stage the US tried unsuccessfully to equate its scheme on corporation tax deferral to the exemption

[49] See Gary C. Hufbauer et al, "The GATT Codes and the Unconditional Most Favoured-Nation Principle", *Law& Pol'y Int'l Bus.*, 12 (1980), p. 70.Also John H. Jackson, The World Trading System, op. cit., p.137.
[50] See John H. Jackson, "United States Law and Implementation of the Tokyo Round Negotiation" in John H. Jackson et al., eds, *Implementing the Tokyo Round*, (Ann Arbor:The University of Michigan Press, 1987) p.170.

of foreign profits principle adopted by some EC member states. A success for the United States, along with the other industrialised countries members of the Organisation for Economic Cooperation and Development, was the inclusion of a safe harbour for export financing consistent with the provision of the OECD Arrangement on guidelines for officially supported export credits. The exception, however, was considered to only apply to interest rates and the United States itself did not acknowledge the Arrangement as a limit to its power of imposing countervailing measures on the import of subsidised products.

# CHAPTER III

## THE UNITED STATES' COUNTERVAILING DUTY LAW AFTER THE TOKYO ROUND

### Introduction

From the Reciprocal Trade Agreement Act of 1934 through the end of the Kennedy Round successive statutes authorised the Executive to negotiate reductions in the US tariff in exchange for reductions by its trading partners and to implement the agreement simply by presidential proclamation, that is without further recourse to Congress. There was no comparable system of advance authorisation when non-tariff trade barriers were at issue, and they became more and more relevant when the success of the subsequent GATT rounds gradually dismantled the tariff wall. The solution – already described in Chapter I – was to grant negotiating authority to the Executive also on non-tariff matters and to provide an up-or-down vote within a specified period of time on any legislation implementing a non-tariff agreement. The Trade Act of 1974 initiated this practice. There were, however, important differences with the previous system of trade authority delegation. In particular, from 1974 onwards Congress had to pass legislation at both ends of the negotiation. This meant that during the multilateral talks US negotiators had to take into account the lawmakers' opinion and, thus, the often contrasting opinions of the interest groups they represented, which could either be more favourable to trade expansion or to protection from foreign competition. On the other hand, although Congress forwent the right to pass amendments on the agreements reached by the Executive, it was unwilling to have no say in the implementing legislation. When in 1979 the moment came to make US law conform to the agreements reached in Geneva, the Carter Administration, in order to ensure congressional support, accepted the proposal of the Senate

Finance Committee to have the implementing bill drafted by the lawmakers rather than by the Executive. And Congress, which could not ignore the lobbying of key industries like steel, made it clear that it saw the trade-remedy law as the cornerstone of the implementing legislation.[1]

The Trade Agreements Act (TAA) of 1979, thus, stands as a cornerstone in the interactive process between multilateral trade rules and US domestic law. As Cohen points out, the TAA can be viewed as an effort to harmonise domestic law with the MTN Tokyo Agreements, concurrently trying to reconcile a wide variety of competing domestic interests.[2] In line with the Tokyo Round compromise, the legislation drafters took into account the interests of those who favoured a reduction of domestic barriers to foreign trade. At the same time, however, they could not neglect the interests of those who considered the passing of the new legislation as an opportunity to strengthen the protection of US industry against increasing foreign competition often helped by public support.

In particular, with regard to countervailing measures the Act did not limit itself to encompassing the Subsidies Code provisions, given the much richer heritage of the US legislation. The Act to comply with the Subsidies Code commitments adopted wide-ranging, but not general, provisions for injury determination. The procedure was largely drawn from that developed in antidumping investigation. The concept of domestic subsidy, which in the multilateral framework appears for the first time in the Tokyo Round Code, was already present in the US countervailing duty legislation and had already been tested in a controversial case. The idea of specificity – requiring that a subsidy to

[1] I.M. Destler, American Trade Policy (Washington D.C.: Institute for International Economics, 1995), p. 149.
[2] Richard A. Cohen, "The Trade Agreements Act of 1979: Executive Agreements, Subsidies, and Countervailing Duties", *Tex. Int. l L.J.*, 15 (1979), p. 103.

be countervailable must be directed to a limited number of beneficiaries - finds its own place in the framework of the 1979 TAA.

The TAA, however, was just a moment, albeit crucial in the development of the US countervailing measures legislation. Other important stages can be found in the Acts of 1984 and 1988. In addition, the creative process of both administrative practice and case law played a central role.

In the following sections we will, therefore, focus on those concepts which either had a major impact on multilateral negotiations or did not coincide with existing multilateral rules. In particular we look at domestic subsidies, specificity, at the idea of benefit to the recipient as opposed to that of charge on the public account, and finally at material injury to domestic industry. Some of these subjects will be reconsidered in subsequent chapters to assess the change in domestic law brought about by the Uruguay Round Agreement. We also postpone to these later chapters the analysis of rules, such as those regarding the allocation of government grants and privatisation, which, though already present prior to the Uruguay Round completion, underwent changes or had a greater international relevance in the period which followed the Uruguay Round Agreements Act of 1994.

**1) Domestic Subsidies**

The first general US countervailing duty statute applicable to all imports otherwise dutiable, the Tariff Act of 1897, only provided for the imposition of countervailing duties whenever a foreign government bestowed, directly or indirectly, any bounty or grant upon the exportation of any article or merchandise. The Tariff Act of 1922, however, widened the scope for countervailing measures covering any bounty or grant "on manufacture or production as well as on exportation, regardless of whether such gratuities were derived from governmental or private sources". Since 1922, therefore, subsidies that were not export-related were also considered countervailable.

Governments as well as local authorities can grant forgiveness of debts and tax deferral or exemption to companies that open plants and create jobs in underdeveloped regions. Grants and tax benefits are offered to shore up firms that accept not to lay off employees during a reconstruction phase. Likewise, many governments provide loans at low-interest rates especially to government-owned companies to help the entire firm operations and not just its export-related activities. Until the 1960s the US administering authority[3] had refrained from imposing duties to offset such forms of public help.[4] Things changed radically a few years later. The watershed is commonly found in the Michelin decision concerning the imposition of countervailing measures on tires produced by a French company, Michelin S.A., in a factory located in the Canadian Province of Nova Scotia to benefit from a series of incentives offered by the provincial government. Although at that time the administering authority did not disclose the reason upon which it relied in determining whether to countervail, and it is, therefore, possible that the duty was imposed on the basis of export subsidisation, the program at issue was clearly designed to attract industry to economically underdeveloped regions of Canada through the offer of development assistance grants[5]

As Guido and Morrone point out, although most of the products would ultimately compete in the US market, the Canadian statutory provisions that

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[3] To avoi d repetition we use various terms to indicate the authority entrusted with countervailing duty proceedings: 1) Department of Commerce; 2) Commerce; 3) DOC; 4) USDOC; 5) International Trade Administration; 6) ITA; 7)administering Authority; 8)investigating Authority (term which also applies to the International Trade Commission – ITC)

[4] D.B. King, "Countervailing Duties – An old Remedy with a New Appeal". *Bus. Law.* 24(1969), p.1181.

allowed the countervailed subsidies in question had no requirement of export capability for programme eligibility.[6] The autonomous countervailability of domestic subsidies gets, however, full recognition after the entry into force of the TAA. Thus, in a case dating back to 1982 the Department of Commerce's International Trade Administration (ITA), countervailing a domestic programme aimed at promoting regional decentralisation, industrial investment and small and medium-sized firms, stated that the certificate of fiscal promotion (CEPROFI) issued by the Mexican government had not the primary purpose of promoting exports, but "may be expected to benefit the entire production of the firm and not export alone".[7]

On the other hand, domestic subsidy countervailability was made dependent on their specificity.

**2) Specificity**

The 1979 TAA added a new section, 771, to the Tariff Act of 1930, applicable to the countries that subscribe to the provisions of the Subsidies Code or assume substantially equivalent obligations. Subsection (5), which introduced the term "subsidy", though stating that it has the same meaning as "bounty or grant" under section 303 of the Tariff Act, broke down countervailable subsidies into export and domestic subsidies. For the first category the subsection referred to the illustrative list in Annex A to the Subsidies Code, whereas for the second category it gave a non- exhaustive list which referred to subsidies provided or required by government action to "a specific enterprise or industry, or group of

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[5] See Robert V. Guido and Michael M. Morrone"The Michelin Decision: A Possible New Direction for U.S. Countervailing Duty Law", *Law & Pol'y Int'l Bus.* 6 (1974) p. 251.
[6] Ibid. p. 258
[7] Final Affirmative Countervailing Duty Determination,Ceramic Tile from Mexico, 47 F.R. 20012 (May, 10,1982).web.lexis-nexis.com/professional/.

enterprises or industries".[8] Although the new section was not directed to those countries outside the scope of the Subsidies Code, to which section 303 of the 1930 Trade Act still applied, both legislative history and subsequent case law statements made it clear that articles 303 and 771 should be read together and, therefore, the requirements of section 771 (5) extended to sect. 303.[9] From the wording of the section, the International Trade Administration of the Department of Commerce developed a test to assess whether bounties or grants bestowed on foreign firms are countervailable by the US. A reading of various Commerce countervailing duties decisions shows that two policy goals underlay the test: 1) to limit the number of claims and, therefore, alleviate tensions with US trading partner, as all industries receive some direct or indirect government benefits; 2) to minimise the distortive economic effects of countervailing duties, positing that specific subsidies misallocate resources from a country's more efficient industries thus interfering with relative advantage in international trade.[10] It is not clear l whether this rational was just worked out by the administering authority or was at the root of the text of subsection. Bello and Holmer argue that these aims were

[8] Section 771 (5) read:
"The term "subsidy" has the same meaning as the term "bounty or grant" as that term is used in section 303 of this title, and includes, but is not limited, to the following:
(A) Any export subsidy described in Annex A to the Agreement (relating to illustrative list of export subsidies).
(B) The following domestic subsidies, if provided or required by government action to a specific enterprise or industry, or group of enterprises or industries, whether publicly or privately owned, and whether paid or bestowed directly or indirectly on the manufacture, production, or export of any class or kind of merchandise:
( I ) The provision of capital, loans, or loan guarantees on terms inconsistent with commercial considerations.
(II) The provision of goods or services at preferential rates.
(III) The grant of funds or forgiveness of debt to cover operating losses sustained by a specific industry.
(IV) The assumption of any costs or expenses of manufacture, production or distribution."
[9] 1979 US Code Congressional and Administrative News. Legislative History, p. 381.
Bethlehem Steel Corp. v. United States. 7 C.I.T. 339, 590 F. Supp. 1237 (1984). web.lexis-nexis.com/professional/.
The Court of International Trade stated that "the primary purpose of the definition of subsidy in section 771(5) of the Act is to make it plain that the term "subsidy" has the same meaning as the term "bounty or grant" and that that there is a complete harmony and continuity between the two provisions".

present in the congressional debate.[11] Greenwald casts doubts over granting Congress such aims, as, in his opinion, when the lawmakers adopted the TAA the term "specific enterprises or industries" was included in a provision which was merely illustrative and was never meant to restrict the reach of countervailing duty law.[12] Greenwald's argument could find some support in the fact that the Subsidies Code did not refer to specificity and the EC rules on countervailing measures did not address this issue, even though both the European Commission and the European Court of Justice expressed the view that measures of a general nature are not subsidies.[13]

**The general availability test**

Taking to its logical extremes the idea of "specificity", in the early 1980s the Department of Commerce based its countervailable subsidy test on the concept of "general availability" whereby, except for export subsidies, benefits that are available to all industries do not confer a subsidy for the purposes of countervailing duty law, even though the number of actual beneficiaries can be limited. What was relevant for the ITA was the objective of the measure, which must not be targeted to a limited number of users or beneficiaries. Thus, with regard to natural resources, the limited number of beneficiaries did not imply specificity if it was the result of the inherent characteristics of the goods covered by the measure. This approach is best illustrated by the so-called "Softwood Lumber I" case concerning the setting of stumpage fees – i.e., the price charged

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[10] See James D. Southwick, "The Lingering Problem with the Specificity Test in the United States Countervailing Duty Law",*Minn. L. Rev.*, 72(1988), p.1173.

[11] Judith Hippler Bello and Alan F.Holmer, "Subsidies and Natural Resources:Congress Rejects a Lateral Attack on the Specificity Test", *Geo.Wash. J. Int'l L.&Econ.*, 18(1984), p.309.

[12] J.D. Greenwald, "US Law and Practice", in Jacques H.J. Bourgeois (ed.) *Subsidies and International trade. A European Lawyer Perspective* (Deventer-Boston:Kluwer Law and Taxation Publisher, 1991) p. 37.
Greenwald argues, on the other hand, that the specificity requirement was definitely codified by Congress when the Omnibus Trade Act added to the previous text of section 771(5) a subparagraph which required the ITA to assess whether a "bounty, grant, or subsidy is in law or in fact provided to a specific enterprise, industry, or group of enterprises or industries".

for logging –at artificially low levels by Canadian federal and provincial authorities. Rejecting the petition, Commerce stated that the stumpage at issue was available on similar terms regardless of the industry or enterprise of the recipient. The only limitation as to the type of industries that use stumpage reflects the inherent characteristic of this natural resource and the current level of technology".[14] Similarly, Commerce found in "Carbon Black from Mexico" that the Mexican Government's provision of natural gas and carbon black feedstock was non-specific as these resources were available to all Mexican industries, though there were only two users of carbon black.[15]

The general availability principle, however, did not apply only to the provision of raw materials or intermediate products. Thus, with regard to investment tax benefits provided by the Korean legislation to all domestic industries, but benefiting in particular the capital intensive steel industry, the Department held that benefits "available to all industries in the manufacturing and mining sector are not limited to a specific enterprise or industry or group of enterprises or industries... thus, they do not provide domestic subsidies".[16]

**The CIT's approach in the Cabot case**

Commerce's liberal approach caused strong opposition from the US industry and from the beginning raised doubts among the judges of the Court of International Trade (CIT). It was finally reversed in the Cabot case, which was an appeal against the negative determination in Carbon Black from Mexico. In its opinion the Court started from the premise that, contrary to Commerce's view, not

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[13] See Kostantinos Adamantopoulos, Subsidies in External Trade Law of the EEC, *E. L.Rev*, 15 (1980), p. 438.

[14] Final Negative Countervailing Duty determination, Certain Softwood Products from Canada, 48 FR 24159 (May, 31,1983). web.lexis-nexis.com/professional/.

[15] Final Affirmative Countervailing Duty Determination and Countervailing Duty Order; Carbon Black from Mexico, 48 F.R. 29564 (June 27, 1983).web.lexis-nexis.com/professional.

[16] Final affirmative determination, Cold-Rolled Carbon Steel Flat-Rolled Products from Korea; and final negative countervailing duty determination, Carbon Steel Structural Shapes from Korea, 49 FR 47284 (December 3,1984). web.lexis-nexis.com/professional/.

all generally available benefits are alike, as "some are accruing generally to all citizens, while others are benefits that when actually conferred accrue to specific individuals or classes". To the first category belongs the provision of so-called public goods, such as national defence, education, and infrastructures, which are not conferred to any specific individual or class. On the other hand, generally available benefits "when actually bestowed may constitute specific grants conferred upon any specific identifiable entities". Secondly, the Court pointed out that what is relevant are the actual results or effects of assistance provided by foreign governments and not their purpose or intention. Considering these premises together, the CIT argued that the appropriate standard must focus on the de-facto case-by-case effects of the benefits provided to recipients rather than on their nominal availability. In the case at issue the Court concluded that the Mexican programme, by providing quantifiable competitive advantages to specific identifiable enterprises, constituted a countervailable benefit, regardless of the possibility for other industries to participate in the programme.[17]

As the case in question illustrates, the reasoning of the Court not only denies the approach followed by the administering authority, but also leads, by necessity, to opposite results. The fact that participation in the programme is actually and not only theoretically opened to other industries is not relevant; the decisive factor is the limited number of enterprises or industries which actually obtain a competitive advantage by means of a governmental subsidy.

Applying the CIT's approach in Cabot, some scholars have argued that Commerce in its investigation should proceed by successive steps. Firstly, it should check if there are de-facto exclusive beneficiaries, and where the number of beneficiaries is too broad it must assess whether a specific industry is a

[17] Cabot Corp. v. United States, 9 CIT 489, 620 F.Supp. 722 (1985) web.lexis-nexis.com professional .

dominant user of the programme, or otherwise receives a disproportionate amount of benefit.[18] The second sotuation occurs either when the industry's share of the total use of the programme is far greater than its contribution to the economy or when it receives a disproportionate amount of benefits from the programme compared with other users because of its economic structure, as it could result from a subsidised input which accounts for 80 percent of industry A's production costs but only a small share of the costs of other industries.[19]

The alternative criterion to "general availability" was further developed by Cameron and Berg, who, however, looked for a more specific parameter from an economic viewpoint. Remarking that generally available subsidies do not benefit all industries uniformly, the two economists suggested that the specificity of the effects be measured by estimating the percentage of the total subsidy absorbed by the industry under investigation relative to that industry's share of gross national product.[20] The closer to 1 the ratio is, the less specific is the grant received by the industry. The higher the percentage, the more specific is the benefit.[21]

This approach, however, has two faults. Firstly, it relies on a static perspective which, in turn, has a protectionist bias, especially against developing countries, as benefits that today are concentrated on an industry, tomorrow could spread to other sectors due to economic progress. Secondly, the criterion does not tell where to draw the line. Certainly a ratio of 1 or lower indicates the absence of specificity, but what about a ratio of 1.2 or 1.5? Are they a definitive index of specificity or do they approach a tolerable amount of concentration?

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[18] John A. Ragosta and Thomas Shanker, Specificity of Subsidy Benefits in U.S. Department of Commerce Countervailing Duty Determinations", Law & Pol'y Int'l Bus., 25(1994), p. 665
[19] Ibid.p 667
[20] Laurie A. Cameron and Gerald C. Berg "The U.S. Countervailing Duty Law and the principle of General Availability", *J.W.T.L.*, 19 (1985), p. 505.
[21] The parameter is given by a double ratio: (S1/S)/(X1/X ), where S1 is the value of the subsidy received by the umpteenth industry; S is the subsidy total value; X1 is the value of production in the umpteenth industry; and X is the Gross National Product.

Following the CIT decision in Cabot, the ITA, while confirming its adherence to the specificity test, abandoned its general availability approach in favour of a distinction between nominal and de-facto availability which must be assessed case-by-case.[22]

**The case-by-case approach**

The perspectives of the Court and of the Department, however, do not coincide, as the CIT in Cabot emphasised the effective results whereas the ITA seems to take as a yardstick the "de facto availability" in contrast to a "de iure. availability". Thus, in the second stage of the never ending dispute over "certain softwood lumber products from Canada", the administering agency held that in determining specificity a variety of factors must be taken into account, such as the extent to which a foreign government acts to limit the availability of a programme; the extent to which it exercises discretion in making the programme available; and, on the other hand, the number of enterprises or industries that actually use the programme.[23]

In a subsequent case, concerning this time a Mexican programme to restructure private firms and to provide natural gas below market rates, the Court of International Trade upheld ITA's determination affirming the need for a case-by-case approach to assess specificity.[24] In PPG Industries v. U.S. the Court, whose decision was affirmed in the appeal, [25] while confirming that general availability is not the "statutory test", held that it can be considered a "manifestation that a programme has not conferred a benefit upon a specific

[22] As one might expect, in the "Carbon Black from Mexico" administrative review Commerce came to the conclusion that there were too few users of the Mexican programme, which, therefore, was countervailable: Final Results of Countervailing Duties Administrative Review, Carbon Black from Mexico, 51 F.R. 30385 (August 26,1986).web.lexis-nexis.com/professional/.
[23] Preliminary Affirmative Countervailing Duty Determination, Certain Softwood Products from Canada, 51 FR 37453 (October.24,1986).web.lexis-nexis.com/professional/
[24] PPG Industries Inc.v. United States, 11CIT 344, 662 F.Supp. 258 (1987).web.lexis-nexis.com/professional/.

firm". In the opinion of the Court, therefore, the standard to be followed by the administering authority is a case-by-case approach in which general availability is "one of several factors in determining whether or not a benefit or competitive advantage has been conferred upon a specific firm". The CIT also held that the fact that a programme contains certain eligibility requirements for participation does not make it countervailable as long as the requirements are not too narrowly drawn.

It seems, therefore, that the Court of International Trade followed two approaches in assessing specificity. The first was the "effects test" whereby a (countervailable) subsidy exists if the benefit alters the competitive position of the producer in the exporting country. The second test, which, at least nominally, was adopted by the ITA, and was upheld by the CIT in "PPG Industries" and in subsequent cases, distinguishes between "de facto specificity" and "de iure specificity", grounded on a case-by-case analysis.[26]

In the aftermath of "PPG Industries", Congress, which had already shown its uneasiness with the ITA's "general availability" approach during the 1984 Trade and Tariff Act debate, introduced in the Omnibus Trade Act of 1988 a subsection B to section 771(5) of the 1930 Tariff Act, as amended. This subsection provided that the administering authority in assessing specificity must look not only to its "de iure availability" but also to its "de facto availability".[27]

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[25] PPG Industries Inc. v. United States, 928 F.2D 1568 (Fed. Circ.1991). web.lexis-nexis.com/professional/.

[26] Can-Am Corp. v. United States. 11 CIT 424, 664 F.Supp. 1444 (1987). web.lexis-nexis.com/professional/.

[27] Section 771(5)(B): "In applying subparagraph (A) the administering authority, in each investigation, shall determine whether the bounty, grant, or subsidy in law or in fact is provided to a specific enterprise or industry, or group of enterprises or industries. Nominal general availability, under the terms of the law, regulation, program, or rule establishing a bounty, grant, or subsidy, of the benefits thereunder is not a basis for determining that the bounty, grant, or subsidy is not, or has not been, in fact, provided to a specific enterprise or industry or group thereof".

The main difficulty with the case-by-case approach lies in the lack of a general parameter to assess specificity and of a rule to establish the priority among the various criteria available.

The dangers inherent in the case-by-case approach are shown by some panel reports under Chapter 19 of the US-Canada Free Trade Agreement. For instance, in "Live Swine from Canada" and in "Softwood Lumber from Canada III" the Panel noted that the ITA's determination resulted from an application of the above listed criteria of Commerce's proposed regulation, i.e., that the number of programme recipients was small relative to the universe of potential beneficiaries, thus actually coinciding with a "result" test.[28]

A hypothetical example can also give an idea of the uncertainty that results from the absence of a single, unequivocal criterion. Let us imagine that the exporting country, as in "Certain steel flat rolled products from Korea", passes a law allowing accelerated amortisation for fiscal purposes which is available to all domestic manufacturing enterprises. The law, however, benefits in particular capital intensive firms which, moreover, are concentrated in a developing industry which is expanding its presence in the US market. This tax benefit would not be countervailed under the "general availability" principle, but, almost certainly, would be countervailed under the "result test". With the case-by-case approach the outcome is uncertain. On the one hand, the administration in the exporting country does not exercise any particular discretion as it applies the law. On the other hand, those firms which, at that particular stage of industrialisation in the exporting country, can actually benefit from the fiscal provision are quite few. Moreover, it can be easily argued that the exporting country's lawmakers in passing the law certainly had in mind the advantages to the industry, which

[28] J.M. Mercury, "Chapter 19 of the United States-Canada Free Trade Agreement 1989-95: A Check on Administered Protection. *NorthWest. J. Int. Law & Buss.*, 15 (1995), p. 581,p.591.

actually is receiving the main share of fiscal benefits. As Tarullo remarks, "the problem with a specificity test is that nearly any government program may be plausibly characterised as either "generally available" or "specifically targeted".[29]

The difficulties inherent in the concrete application of the specificity test have caused some scholars to doubt its consistency with the efficient allocation of resources, which, in their view, should be the benchmark of countervailing measures. Thus Lay argues that general availability of subsidised inputs does not prevent users from shifting resources into comparatively inefficient directions, nor does the test take into account the fact that subsidies are sometimes aimed at offsetting efficiency-reducing externalities.[30] An example of the latter could be found in the treatment of subsidies to channel investments towards economically depressed areas. The US considered a foreign government subsidy made available only to business located in a particular state or region of the foreign country to be specific and therefore countervailable, even though it was generally available within that province. Commerce, starting from a set of investigations concerning domestic subsidies to European steel industries,[31] considered that subsidies used to alter the comparative advantage of certain regions are by definition a distortion to resources and trade .[32] In turn, Congress did not include the disadvantage of locating in an underdeveloped region among the few specific "offsets" that can be taken into account in the calculation of the "net" subsidy.[33] The outcome, legitimate as it may be in the multilateral environment prior to the Uruguay Round SCM Agreement, partakes of biased formalism, if one considers

[29] Daniel K. Tarullo, "Beyond Normalcy in the Regulation of International Trade", *Harv. L. Rev.*, 100 (1986-7), p. 561
[30] William Lay," Redefining Actionable Subsidies under U.S. Countervailing Duty Law", *Col. L.Rev.*, 91 (1991) p. 1510.
[31] See, e.g., Final Affirmative Countervailing Duty Determination,Certain Steel Products from Belgium, 47 Fed.Reg. 39304.(September 7,1982)
[32] For a critical analysis of the US viewpoint on regional subsidies see Pieter Matthijs Alexander, The Specificity Test under US Countervailing Law", *Mich.J.Int'l.L*, 10 (1989), p. 833.
[33] See Daniel K. Tarullo, Beyond Normalcy, op.cit., p. 565.

that under the US regime benefits granted by local authorities to all enterprises that locate their investments in their territory, whatever the place of incorporation, are not countervailable.

The foregoing provides a first example of what was said in chapter I about the extent and features of the alleged protectionist bias in the US administrative protection regime. Here the law does not contain any inherent limitation on imports from a third country. On the contrary, it goes beyond the provisions of the General Agreement and of the Subsidy Code. On the other hand, specificity does not provide waterproof protection against protectionist bending of countervailing measures. In reply to Greenwald's praise of US moderation in enforcing countervailing law, due, in his opinion, primarily to Commerce's adoption of the specificity test Vermulst remarks that "it is misleading to focus excessively on the Commerce Department as the law is made by a multitude of actors, including in addition to the Commerce Department the International Trade Commission, the Court of International Trade and the Court of Appeals for the Federal Circuit".[34] Here, the ITA applied a liberal construction of the law, but its approach was countered by the Court of International Trade which preferred a more restrictive construction. The end result is quite ambiguous and does not provide a clear guidance for foreign exporters. In certain cases, such as regional subsidies, its application, in the absence of corrective provisions, could penalise otherwise legitimate foreign programmes.

**3)Upstream subsidies**

Some of the cases in which the concept of specificity was tested and developed concerned the supply of inputs by public entities to national industries

[34] E. Vermulst, "Comment", in Jacques H.J. Bourgeois, ed., *Subsidies*, op.cit. p.49

at subsidised prices.[35] In such cases the subsidisation is direct and the only beneficiary is the end producer. Similar but more complex is the case of a subsidy bestowed on the production of an intermediate domestic product which is used as the input of an unsubsidised product exported to the US, where the latter is subject to a countervailing measure investigation because alleged competitive benefits, in the form of lower costs of production, accrue to the exporter.

Counteravailability of upstream subsidies, which are the dominant form of indirect subsidies, posits, therefore, a flow-down effect from the intermediate product to the final one. No TAA provision expressly dealt with this issue, and, therefore, investigations of upstream subsidies were initially based on the interpretation of sections 701 (5) and 303 of the Tariff Act of 1930, which provided for countervailabilty of indirect subsidisation. The administering authority in assessing upstream subsidies was careful not to exploit the potential for countervailing measures to the outmost extent. Thus, in the 1982 steel cases against European Community producers the Department of Commerce made the imposition of countervailing duties conditional on the absence of an arm's length transaction, arguing that if a sale is transacted at arm's length, benefits bestowed to the manufacturer of an input do not flow-down to the purchaser as the former attempts to maximise its total revenues by charging as high a price as the market would bear.[36] Moreover, in the opinion of the Department, the fact that the input producer and the consumer are related companies does not prevent an arm's length transaction whenever the former sells to the latter at the prevailing market

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[35] See Final Negative determination,Anhydrous and Aqua Ammonia from Mexico, 48 F.R. 28522 (June 22,1983).web.lexis-nexis.com/professional.
Carbon Black from Mexico, note 13.
For an analysis of the case law and the legislative response to subsidisation of intermediate products, see Janet Zoe Barsy, "Upstream Subsidies and US Countervailing Duty Law,: The Mexican Ammonia Decision and the Trade Remedies Reform Act of 1984", *Law &Pol'Y Int'l Bus.*, 16 (1984), p.263-298.
[36] Final Affirmative Countervailin Duty Determination Certain Steel Products From Belgium, 47 F.R. 39304 (September 27,1982). web.lexis-nexis.com/professional.

price, or at least at a price not different from that charged to unrelated purchasers.[37]

Quite surprisingly, given the frequent accusation of administrative protectionism levelled against the investigation of subsidised imports, two scholars have contended that the ITA's assumption that in most cases sellers of intermediate products do not pass subsidisation benefits to their clients except when price elasticity is higher than unity does not withstand the scrutiny of economic theory.[38] Both Koenig and Giesen argue that economic theory shows that subsidies are, at least, partially passed through and that the benefit transfer is the greater the more unelastic the demand curve is.

This argument would have justified a much greater number of positive determinations in upstream subsidy investigations. It can be argued, however, that the geometric demonstration on which the criticism is based ignores, in a simplistic way, the assumption which Commerce's investigations relied on: it is rather likely that intermediate input producing enterprises maximise their profits not by passing benefits through lower prices and concurrently increasing supply, but by keeping prices fixed and controlling supply, especially when demand does not fully react to price variation. In technical wording, in this instance supply tends to become unelastic. That would not result just in the shift of the supply curve downward due to the cost reducing effect of subsidisation, but concurrently in an alteration of the supply slope which becomes steeper, thus meeting the demand curve at a higher price level and at a lower quantity.

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[37] Final Affirmative Countervailing Duty Determiation Certain Steel Products from the Federal Republic of Germany, 47 F.R. 39345 (September 7,1982). web.lexis-nexis.com/professional. Final Affirmative Countervailing Duty Determination Certain Steel Products from France 47 F.R. 39332 (September 7,1982). web.lexis-nexis.com/professional.

[38] Peter J. Koenig, "Upstream Subsidies and U.S. Countervailing Duty Law", in John H. Jackson et al., eds., *International Trade Policy:The Lawyer's Perspective* (New York :Matthew Bender, 1985), p. 9-9 – 9-15.
Hans-Michael Giesen, "Upstream Subsidies: Policy and Enforcement Questions after the Trade and Tariff Act of 1984", *Law &Pol'Y Int'l Bus.*, 17 (1985), p.268-278

Commerce's moderate approach was incorporated in the 1984 Trade and Tariff Act which makes the imposition of countervailing duties on the exported merchandise conditional on three elements: the input supplier must receive domestic subsidies; the subsidy must confer a competitive benefit on the exported output; and it must have a significant effect on the cost of the product under investigation.

The 1984 Act added a new section 771 A to the Tariff Act of 1930. This section limited upstream subsidy countervailability only to those domestic subsidies, as opposed to export subsidies, which are listed in section 771(5) (I),(II), and (III).[39] Thus, the provision of capital, loans, and loan guarantees, the provision of goods and services, and the grant of funds or debt forgiveness to cover operating losses are covered. On the other hand, subsidies in the form of fiscal acknowledgement of accelerated depreciation for certain sectors of the national economy are excluded from the provision.[40]

The term competitive benefit has a non-technical meaning, as benefit is considered to be bestowed when the input product price is lower than the price the producer of the merchandise under investigation would pay to another seller in an arm's length transaction. The provision, therefore, substantially reproduced, and went even further than, the above-mentioned practice of Commerce which required proof of the passing on of the benefit derived from subsidisation. Indeed, under the section, even though the whole subsidy is passed on but the price to the exporter is higher than the price offered by an independent producer, no countervailing duty can be levied on the final product. For instance, in "Cold-Rolled Carbon Steel Flat-Rolled Products from Korea", the ITA found that no competitive advantage had been conferred on the Korean steel producers as they

[39] See Supra section 2, note 8.
[40] Hans-Michael Giesen, Upstream, op.cit., p. 288.

had bought the bulk of the allegedly subsidised iron ore production at prices higher than what they paid to foreign unsubsidised suppliers.[41] On the other hand, the 1984 Act allows the administering agency to use alternative benchmarks to assess a competitive advantage when it has determined in previous proceedings that the independent producer input that is used for comparison is subsidised too. In such a case Commerce may adjust the price to reflect the effect of the subsidy, or select a price from another, non-subsidised, source.

The third element to be considered by the ITA in its determination is the effect of the input subsidy on the product under investigation, which must be significant. The effect in question also determines the maximum amount of countervailing duty that can be imposed on the exported product. Thus, if, for instance, the competitive benefit brought about by the difference in price between the subsidised input and a product obtainable in an arm's length transaction is ten, and the flow-down subsidy totals five, the countervailing duty cannot exceed the latter amount.

Section 771 A made it clear that it is not the input itself but the subsidy that must have a significant effect on the cost of the final merchandise. A three-step assessment was, therefore, required. Firstly, the ITA must calculate the subsidy on the input, expressed in "ad valorem" terms; secondly, it must establish the share of the input on the cost of production of the final good, expressed as a percentage; thirdly, it must multiply the two percentages.[42]

The section, however, provided no benchmark to determine whether the effect is relevant., leaving it to the administering authority. In one of the earlier cases Commerce created a rule of thumb to determine the relevance of passed-on subsidisation: if the input subsidy allocated to the final product exceeds five

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[41] Final Affirmative Countervailing Duty Determination, 49 F.R. 47284 (1984).

percent, a rebuttable presumption of significant effect is established. If the amount is less than one percent, there is a rebuttable presumption that the subsidy has no significant impact.[43]

So far it seems that the United States has only developed a concept, indirect subsidisation, already present in the General Agreement, just establishing the benchmarks for its assessment, also in the interest of exporters under investigation. The parameters worked out in the aftermath of the Tokyo Round turned out to be too narrow to offer a wide enough buffer against foreign competition, at least in the sector of agricultural produce and its processed products. Thus, Canadian swine, primary commodity for the production of pork, provided the dominant quota of the value added of the final product. Yet, it would have been very difficult for the US pork industry to prove that the subsidised commodity conferred a competitive benefit to the Canadian pork producers. Commerce decided to overcome the obstacle by considering the breeding of pigs and pork production as two parts of a single production process. ITA justified its decision arguing that little value was added at the processing stage and, therefore, the demand for the raw product was substantially based on the demand for the processed product.[44] The decision to consider pork export as the final stage of a single process also entailed higher countervailing duties, as the subsidy granted to swine breeders was not viewed as an indirect benefit but as a direct subsidy to be, therefore, countervailed for its total amount rather than just according to the percentage share of the input in the final product value.[45] The Court of International Trade, however, rejected this approach, asserting that no exception

[42] If the subsidy comes to 10 percent of the input's value and the input weight on the total cost of the product under investigation is 20 percent, the effect of the flowed-down subsidy is 2 percent.
[43] Final Affirmative Countervailing Duty Determination, Certain Agricultural Tillage Tools from Brazil. 50 F.R. 34525 (August 6, 1985). web.lexis-nexis.com/professional.
[44] Final Affirmative Countervailing Duty Determination:Live Swine and Fresh Chilled and Frozen Pork Products from Canada, 50 F.R. 25097 (June 17,1985). web.lexis-nexis.com/professional.

had been provided in the 1984 upstream subsidy rules with reference to agricultural products.[46]

Lawmakers soon came to the rescue of domestic industry. Section 1313 of the 1988 Omnibus Trade and Competitiveness Act introduced section 771 B to the Tariff Act of 1930 which provides that when the demand for unprocessed agricultural products is substantially dependent on the demand for processed agricultural products and when processing adds only limited value to the commodity, subsidies to the raw agricultural products are deemed to be provided with respect to the exported manufactured products.[47] The US National Pork Producer's Council filed another countervailing duty petition and Commerce imposed countervailing duties to offset the total amount of the subsidy bestowed to Canadian swine producers.[48]

The consistency of the new US approach was, however, questioned by the GATT to which Canada lodged a complaint. The Panel maintained that with regard to upstream subsidies proof must be given that the exporter of the final product has received a benefit as long as it is a separate industry operating at arm's length with the intermediate product industry to which a subsidy has been granted. In the case in question, therefore, determination that pork production had been subsidised required an examination of the impact of the subsidy on the price of swine.[49] The question was whether the price Canadian pork producers paid to swine breeders was lower than the price they had to pay to other available

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[45] See Marc Benitah, *The Law of Subsidies under the GATT/WTO System* (Hague,London:Kluwer Law International, 2001) p.207

[46] Canadian Meat Council v. United States, 11 CIT 362; 661 F.Supp. 623 (1987) web.lexis-nexis.com/professional.

[47] See Gilbert B. Kaplan, Susan Haggerty Kuhback and Ronald Lorentsen, "Antidumping, Countervailing Duty and National Security Provisions in the 1988 Trade Act", *Geo.Wash.J.Int'l. L.&Econ.*, 22(1989), p. 607.

[48] Final Affirmative Countervailing Duty Determination;Fresh Chilled and Frozen Pork from Canada, 54 F.R. 30774 (July 24,1989). web.lexis-nexis.com/professional.

[49] Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada. Report by the Panel Adopted on 11 July 1991 (DS7/R). 38 Supp. BISD. p.30, para.4.9.

sources. The answer to this question could not be premised, as the US law assumed, just on the dependence of the demand for swine on the demand for pork and on the limited value added in the production of swine into pork. [50]

**4)Market as the primary benchmark for subsidisation assessment.**

GATT art. VI provides that no countervailing duty shall be levied in excess of the estimated subsidy. However, neither the General Agreement nor the Subsidies Code defines what constitutes a subsidy and, therefore, which is the benchmark to ascertain its existence and to assess its amount. The answers given to this question by the main GATT parties differed. To understand the US approach one must compare it with the EC approach.

The European Community linked subsidy to a charge on the public account. The Community's position was stated in a series of complaints lodged by the Seed Crushers and Oil Processors Federation (FEDIOL) against the European Commission's failure to impose countervailing duties on imports of processed soya products from Argentina and Brazil.[51] According to the Federation, Argentina and Brazil indirectly subsidised soy meal and oil by imposing a lower export tax on soy products than on the unprocessed produce, thus reducing raw commodity exports and concurrently increasing domestic supply with the result of lowering prices for producers of soy-based products. The Commission considered that this practice was not a subsidy, particularly because it did not involve a charge on the public account, as the differential system of taxation did not constitute an exemption from taxes otherwise due to government. The European Court of Justice upheld the decision on the ground that the last paragraph of the

[50]Ibid. para. 4.10.
[51] ECJ Case 187/85 EEC Seed Crushers and Oil Processors' Federation (Fediol) v Commission of the European Union(1988) E.C.R. 4155;

illustrative list annexed to Regulation 2176/84 on countervailing measures, which reproduced paragraph 1 of the annex to the Subsidies Code, read "any other charge on the public account". It has been remarked, however, that in the first place other items in the EC illustrative list did not necessarily involve a cost to government, and that, at any rate, the Regulation itself stated explicitly that the practices listed in the illustrative list were not exhaustive.[52]

The United States administrative practice and case law lie at the opposite end of the spectrum focusing on the benefit to the recipient relative to the condition prevailing on the market. The US viewpoint is stated clearly in the 1992 "Certain Softwood Lumber Products from Canada" final affirmative determination. Commerce justified its decision to impose countervailing duties on the imports of Canadian softwood lumber products by pointing out that neither the GATT nor the Subsidies Code requires proof of government financial contribution. In this context the ITA argued that even export restrictions imposed by a local authority can constitute a countervailable domestic subsidy. Likewise, the provision by a government of a good or service at differential rates confers a countervailable benefit even though the programme does not involve a charge on the public account. In this particular instance the only thing required to trigger the imposition of countervailing duties is that the price charged for goods or services is "less than the benchmark price which normally will be the non-selective prices the government charges the same or other users of the goods or services within the same political jurisdiction" [53]

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ECJ Case 188/85 EEC Seed Crushers and Oil Processors' Federation (Fediol) v Commission of the European Union (1988) E.C.R. 4193

[52] See in particular M Bronckers and R. Quick, "What is a Countervailable Subsidy under EEC Trade *J.W.T.*, 23 (1989) *6*, p. 13.

[53] Final Affirmative Countervailing Duty Determination: Certain Softwood Lumber Products from Canada, 57 F.R. 22570 (May 28,1992). web.lexis-nexis.com/professional.

*1) Facilitated loans*

The American approach is illustrated by the treatment of government supported loans. Section 771 (5) of the 1930 Tariff Act, as amended by the TAA, included as countervailing subsidies the provision of capital, loans, and loan guarantees on terms inconsistent with commercial consideration. Wide use of this provision was made in the steel cases of the early 1980s. In particular, with regard to government supported loans subsidy was computed by comparing what the company would pay in principal and interest on a normal commercial loan to what the company actually paid on the preferential loan. The treatment reserved to so-called uncreditworthy companies was particularly severe. Companies were considered uncreditworthy when it would have been extremely difficult for them to borrow in the commercial market as they lacked sufficient revenues or resources to meet their costs and fixed financial obligations. Such a condition was particularly associated with persistent losses. Government loans to such enterprises were equated to contributions to capital, measured by the difference between the enterprise's rate of return on equity and the country's average rate of return on equity. Commerce justified this approach by the low probability of repayment of these loans.[54]

This extremely penalising approach was later abandoned when the ITA laid down more detailed rules for the assessment of loan and loan guarantee subsidies in the appendix to the final determination in the "Cold-Rolled Carbon Steel Products from Argentina" case.[55]

For long term loans subsidy assessment was carried out in three stages. First, a comparison was made between what a company would pay a normal

[54] Final Affirmative Countervailing Duty Determinations: Certain Steel Products from Belgium "Appendix 2", 47 FR 39304 (September 7, 1982). web.lexis-nexis.com/professional.

commercial lender in principal, interest and other charges in any given year and what it actually pays on the preferential loan in a given year. The benchmark usually used was company specific, in order to take into account the riskiness of each enterprise. If the company had not taken out comparable commercial loans, Commerce resorted to a national average loan interest rate or to the interest rate and other conditions applied to a comparable company. After calculating the payment differential between the benchmark loan and the loan under investigation, the present value of the stream of benefits was determined using a discount rate, given by the weighted cost of capital in the country concerned. Finally, the discounted amount was allocated over the life of the loan.

For long-term loans to companies considered uncreditworthy a risk premium was added, which was calculated as the difference between the bond ratings of the least and most creditworthy companies in the country in question.

The assessment of the benefit for short-term loans was more direct as credits whose redemption date does not exceed one year were considered less risky than long-term loans. The benchmark used by Commerce is the national average short- term interest rate. As the loans in question are repaid within a year, benefits were allocated to one year only.

2) *Provision of capital*

Reference to the market is also at the basis of the treatment of government equity investments. According to section 771(5), provision of capital countervailability results from its inconsistency with commercial consideration. No light is shed, however, on the precise meaning of the latter term.

In the early stages of the steel cases Commerce focused on the recurrence and amount of losses to determine whether the investment were inconsistent with

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[55] Final Affirmative Countervailing Duty Determination and Countervailing Duty Order: Cold-Rolled Carbon Steel Products from Argentina "Appendix", 49 F.R. 18006 (April 26,1984).

sound business criteria.[56] Later, however, the administering agency concluded that a firm's lack of profitability in the past was just a factor in assessing whether an investment is consistent with commercial consideration, as companies that suffer economic vicissitudes could show losses, and still represent sound investments if they can revert to profitability.[57]

Commerce, therefore, assessed commercial consideration from the perspective of an investor at the time the investment was undertaken: the so-called "outside reasonable investor test". According to this approach, the ITA first considered the value of the stock as determined by the market. To the extent that a government procures stock at market price, there is no subsidy. If it pays a premium price for shares, the investment is alleged to be inconsistent with commercial consideration. When there is no market-determined price, the government must act as an outside investor, weighing a variety of factors, such as the company's ongoing financial situation, its profit and loss records, and its future prospects, taking into account studies and forecasts of the market and in particular of the industry of which the company is a part. If government equity purchases are deemed inconsistent with commercial consideration, the benefit is measured by multiplying the difference between the company's rate of return on equity and the national average rate for the review period by the total amount of equity purchases made in years in which the company was "unequityworthy"[58]

ITA's reliance on the reasonable investor parameter, however, is not free from risks, some of which have been recognised, in principle, by Commerce itself.

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[56] See, e.g., Preliminary Affirmative Countervailing Duty Determination; Certain Steel Products from Belgium 47 F.R. 26300 (June 17,1982). web.lexis-nexis.com/professional.

[57] See Final Affirmative Countervailing Duty Determination:Carbon-Steel Structural Shapes, Hot-Rolled Carbon Steel Plate and Hot-Rolled Carbon Steel Bars from the United Kingdom 47 F.R. 39384 (September 7,1982). web.lexis-nexis.com/professional.

[58] Ibid.

Also Cold-Rolled Carbon Steel Products From Argentina, 49 F.R. 18006 (April 26,1984),note 49. web.lexis-nexis.com/professional

For instance, investment in ailing industries can be consistent with commercial consideration in the context of reorganisation, especially if they do not aim at increasing production capacity but at preventing negative social effects such as extensive redundancy of workers. [59]

Recognition in principle, however, is not the same as actual recognition, whose occurrence is made very unlikely by the reasonable investor approach established by Commerce. The limits and faults of this approach are shown by the "British Steel Corporation" case in which the Court of International Trade (CIT) partially upheld Commerce's positive determination of subsidisation by equity infusion in a state-owned British steel enterprise.[60]

The plaintiff, British Steel Corporation, contended that government equity infusion in loss-incurring companies is consistent with commercial consideration on two foundations:

1) Firms should continue operations and their owners, whether private or public, should continue to cover operating losses as long as revenues exceed variable costs.

2) Investors should undertake investment schemes or fund the completion of ongoing schemes where the discounted cash-flow of the investment exceeds its costs.

The Court did not accept British Steel's arguments. Though taking care to stress that equity infusion in loss-incurring companies does not per se confer a subsidy, the CIT pointed out that prospective excess of revenue over operating costs can be a useful analytical tool for the owner/manager to decide whether to continue operating a loss-incurring company, but the test is inappropriate to

[59] See Charlene Barshefsky, Alice L. Mattice, William L. Martin II, "Government Equity Participation in State Owned Enterprises:An Analysis of the Carbon Steel Countervailing Duty Cases", *Law &Pol'Y Int'l Bus.*, 14 (1982-83), p.1134.

investment decisions by private investors. For the latter it would not be commercially reasonable to provide funds without adequate assurance of the future profitability of the enterprise and return of its investments within a reasonable time. With regard to the second point, the Court remarked that comparison between present discounted value of revenues and costs of a capital project can be usefully applied to appraise individual projects but it is not apt to appraise the company's overall condition, which is relevant in deciding whether to inject fresh capital. On the other hand, it allowed that decisions on individual capital projects can be of relevance for the overall health of the company and, therefore, for equity investment decisions.

The fault with these arguments is their restrictive identification of commercial consideration with the private investor's viewpoint whose main aim is the pursuit of profit within a reasonable time. Other elements, perfectly consistent with commercial reasonableness, can be taken into account by the owner/manager or by the parent company in a group. In deciding whether it is worthwhile to buoy up ailing companies, corporate reorganisation does not only entail weeding-out but can call for new investments. In short, an investment decision that is inconsistent with commercial consideration from the angle of the investor in the capital market can be perfectly reasonable if viewed from the perspective of the firm concerned or of the group to which the company belongs. Paradoxically the exclusive reliance on the market benchmark ends up discriminating against state-owned enterprises just because capital infusion necessarily involves a charge on the public account.

**5) Material injury**

[60] British Steel Corp. v. United States, 10 CIT 224; 632 F.Supp. 59 (1986). web.lexis-nexis.com/professional

The gap between multilateral and domestic regulation remained quite wide with reference to injury determination. Unlike antidumping, prior to the Trade Agreements Act (TAA) of 1979, the injury requirement provided by GATT art. VI did not apply to countervailing duty cases in the United States because of the grand-father clause under which a Party to the General Agreement was not required to change pre-existing laws. The only exceptions concerned non dutiable imported goods which until the beginning of the 1970s were not subject to countervailing measures. The extension of countervailing procedures to these imports, therefore, was not covered by the grandfather clause and the Trade Act of 1974 introduced an injury determination provision limited to such goods. Applying the antidumping regime, the 1974 Act required the US International Trade Commission (ITC) to carry out the injury test while subsidy assessment was entrusted to the Department of Treasury, later replaced by Commerce.

The split responsibility regime was extended by the TAA of 1979 to dutiable goods. However, as already noted in chapter II, the injury test only applied to goods from countries which were signatories to the Subsidies Code or which had assumed substantially equivalent obligations, whereas the regime previously in place still applied to all other countries for which the finding of subsidisation was the only requirement to imposing countervailing duties.

In line with the Subsidies Code, sect. 701 of the Tariff Act of 1930, as added by the 1979 TAA, provided that if the ITC determines that an industry in the United States is materially injured, or is threatened with material injury, or the establishment of an industry in the United States is materially retarded by reason of imports of the merchandise under investigation, a countervailing duty should be imposed upon that merchandise. The US industry was defined as either the whole of domestic producers of a like product or those producers whose collective output constitutes a major proportion of the domestic production of the product in question. With a wording rather inelegant but substantially equivalent to the Subsidies Code, "like product" was defined by the mentioned section as a product which is like or, in the absence of like, more similar in characteristics and uses with the article subject to investigation.

The Court of International Trade – whose judgement was affirmed by the Federal Circuit - held that the determination of domestic industry by the ITC can differ not only from the petition but also from the findings of the administering authority in the Department of Commerce, thus stressing the independence of the investigations.[61]

In line with the General Agreement, the new section allowed partition of the US affected industry into regional industries whenever the producers in a regional market sell all or almost all of the production of the like product in that market and the local demand is not supplied, to any substantial degree, by producers of the product in question located elsewhere in the United States.

1) *The assessment of subsidy impact*

The real problem lay, however, in the assessment of causation. It is here that the US rules often seem to be out of line with the relevant provision of the Subsidies Code which explicitly provides for a causal link between subsidy and injury, and, therefore, can be bent to protectionist ends. The United States at first tried to avoid reproducing the term "material injury" provided by the General Agreement and by the Subsidies Code, and only accepted its encompassment in the TAA on the insistence of the other signatories. The other parties contended

[61]Torrington Company v. United States, 14CIT 648, 747 F. Supp. 744 (CIT 1990). web.lexis-nexis.com/professional.
Torrington Company v. United States 938 F.2D 1278 (Fed.Circ.1991). web.lexis-nexis.com/professional.

that material injury is greater than mere injury while the US argued that the verbal difference was meaningless. The Tariff Act, as amended, provided that material injury means harm which is not inconsequential, immaterial or unimportant.[62]. In practice the TAA extended to the new regime the interpretation of the term "injury" developed under the preceding antidumping statute, that is, something more than "de minimis" harm to domestic industry. That was to contrast the term in question with "substantial cause of injury" used in the escape clause implementing article XIX of GATT 1947, which according to art. 201 of the Tariff act implied that imports are to be considered "a cause of injury which is as important and not less important than any other cause". Legislative history also makes it clear that in countervailing measure and antisubsidy investigation the ITC is not requested to weigh the causal factors that determine injury. What is relevant is merely that subsidised imports are one of the causes.[63]

Under section 771 (7) (B) the Commission in making its injury determination was to consider: the volume of imports of the merchandise under investigation; their effect on the price of like products in the United States; and their impact on domestic producers of like products. The text focuses, therefore, on the volume of the imported merchandise and on its impact on domestic producers of like products.

A first question that confronted US administrative bodies and courts was the sequence of steps to be adopted in injury determination. There were two competing approaches – the "bifurcated analysis" and the "single determination analysis". According to the first approach, prevalently followed by the International Trade Commission, the first step is to determine whether the US industry has been materially injured and, if the answer is in the affirmative, to

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[62] Sect. 771(7) (A)

make a determination as to whether material injury has been caused by the subsidised or dumped imports. It follows that if the domestic industry is in good health no causal test will be carried out with regard to the allegedly subsidised goods. In contrast, single determination analysis directly looks at the impact of the imports on the performance of domestic industry which could lead to an affirmative determination even though the domestic industry is not unhealthy.[64]

The requirement of an analysis of the effects of the imports under investigation, especially if carried out according to the single determination approach, highlights a potential discrepancy between the Subsidies Code and the enforcing TAA provisions. The former provided for proof that subsidised imports are causing injury, through the effect of subsidy,[65] whereas the latter merely provided that the ITC should determine whether injury occurs by reason of imports of the merchandise under investigation. The distinction is not an irrelevant one as the impact of the imported goods can stem not only from subsidisation but also from a variety of competitive advantages which are not necessarily linked to the former. The gap between the wording of the texts is made even more relevant by the fact that, as we have seen, the Commission is not required to weigh the factors that concur in the causal process [66].

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[63] David Palmeter, "Injury Determination in Antidumping and Countervailing Duty Cases. A Commentary on US Practice". *J.W.T.L*, 21 (1987), p.31 .

[64] Paul W.Jameson "Recent International Trade Commission Practice Regarding the Material Injury Standard. A Critique, *Law &Pol'Y Int'l Bus.*, 18 (1986), p.526.

[65] Art.6.4

[66] The difference between the approaches in question is clearly illustrated by Vice Chairman Ronald Cass in his dissenting opinion in New Steel Rail from Canada (Investigation n. 701-TA-297 – Final -1989): "...Rather the difference is between two approaches that look at imports. One examines the way unfairly traded imports affect the US industry, in contrast to the effects that would be felt if the unfair practice did not exist. The other approach examines the effect of imports regardless of the degree to which they are unfairly traded. In this latter view, the effect of a .05 percent subsidy to imported widgets is not distinguishable from that of a 50 percent subsidy. The critical factor for this view is the total number of widgets imported"

Contrary to what Granet suggests, US legislative history does not support the idea of a complete alignment of the TAA with the Subsides Code.[67] In particular, if the Senate Finance Committee seems to have interpreted the relevant provisions of the Trade Agreements Act in the light of the Code requirement of a causal link between subsidy and injury, the report of the House Ways and Means Committee is more ambiguous, simply stating that the TAA draft contains the same causation element as the previous law, i.e., that "material injury must be by reason of the subsidised or less than fair value imports". Granet also argues that the timing provisions of the TAA imply that the ITC must take into account the antidumping and subsidy assessment carried out by the Department of Commerce either under a preliminary or final determination, and, therefore, the Commission should refer to the assessment of subsidy in its determination of causality.[68] However, as noted above, the courts have affirmed the independence of the investigations carried out by the administering authority and by the ITC, even stating that the domestic industry determination carried out by the two bodies can differ. This casts doubts on the suggestion that the assessment of subsidisation is a necessary component in determining the link between subsidised imports and injury to a domestic industry.

*2) Cumulation*

On the other hand, the subsequent legislative history, with just one relevant statutory exception, bears out that US lawmakers focused on the impact of imports rather than on the effects of subsidisation. Thus, a 1984 amendment to the Tariff Act, going far beyond the provisions of the General Agreement and the Subsidies Code, provided that in its investigation the ITC must "cumulatively

[67] Lloyd Granet, "ITC Injury Determination in Countervailing Duty Investigations", *Law &Pol'Y Int'l Bus.* 15 (1983), p. 992.

assess the volume and effect of imports from two or more countries of like products subject to investigation if such products compete with each other and with like products of the domestic industry of the United States".[69] The provision, which made a practice intermittently followed by the ITC in antidumping proceedings since the early 1960s compulsory for both subsidy and countervailing duty procedures[70], lent itself to the accusation of being biased against minor producers, especially those in developing countries, as it did not take into account the different impact of imports from major suppliers, which dominate an import trade, and imports from minor sources.[71]

The protectionist bias of cumulation is particularly noticeable with regard to cross-cumulation and "de minimis" import volume.

Cross-cumulation implies that imports alleged to be sold at less than fair value are to be cumulated with imports alleged to be subsidised in assessing material injury to domestic industries. The Commission refused to apply cross-cumulation in its investigations, arguing that the Trade Agreements Act had implemented two separate multilateral agreements, the Subsidies and Antidumping Codes, requiring, therefore, two separate injury tests. The Court, however, rejected the ITC's opinion pointing out that in passing the 1984 Act, Congress had expressed concern with the combined effects of all unfairly traded imports upon domestic industries and that "the definition of material injury and the causal link between injury and the unfairly traded imports are identical for subsidy and antidumping investigations and are outlined in a common statutory

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[68] Ibid., p. 996.
[69] Sect. 771 (c ) (7) (iv)
[70] The first reported case is Portland Cement from Portugal. Inv. N. AA1921-16, TC Pub. 37 (oct.1961)
[71] See N. David Palmeter, Injury Determination, op.cit., p. 38. Palmeter contends that mandatory cumulation turns countervailing and antidumping investigations into a substitute for escape clause relief, without containing the procedural and substantive standards of that law.

provision"[72] The decision was affirmed by the Court of Appeals for the Federal District.[73]

ITA's attitude over the question of the cumulation of imports from different countries, some of which have minimal bearing on the product market under examination was much stricter, also because the text of the 1984 Act left very little room for flexibility. Here it was the legislator that in a subsequent statute tried to make the effects of cumulating less severe and, therefore, less protectionist. Section 1330 (b) of the Omnibus Trade and Competitiveness Act of 1988 established an exception for countries with minimum amounts of exports in the product market. The Act, however, did not specify the level under which imports are to be considered "de minimis", thus increasing ITA's leeway in assessing the impact of importation. On the other hand, legislative history shows that Congress intended the exception to be applied narrowly so as not to subvert the purpose of cumulation.[74]

**Conclusion**

Even after the closure of the Tokyo Round, countervailing duty regulation and, therefore, the identification of countervailable subsidies, remained entrusted to the importing state.

Rule making and its administrative implementation were particularly dynamic in the United States. Sometimes US instruments and administrative practice develop concepts, which were already present in the General Agreement and in the Subsidies Code. Frequently they go beyond what can be drawn from

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[72] Bingham & Taylor Division, Virginia Industries Inc. v. United States. 10 CIT 67, 627 F.Supp. 796 (1986). web.lexis-nexis.com/professional.

[73] 815 F.2d 1482(Fed.Circ. 1987). web.lexis-nexis.com/professional.

[74] Gary N. Horlick and Geoffrey D. Oliver, "Antidumping and Duty Law Provisions of the Omnibus Trade and Competitiveness Act 1988", *J.W.T.*, 23 (1989) n.*3*. p. 37.

multilateral rules. Finally, in some cases, a divergence between US regulations and multilateral rules can be detected.

Domestic subsidies had been considered as potentially countervailable in the US long before the Tokyo Round closure. Hence, the acknowledgement that domestic subsidies can be trade distorting was one of the objectives of the US negotiators during the Round. The concept of specificity is developed by US statutes, by ITA's implementation and by case law with no exact reference to multilateral rules. The regulation of upstream subsidies develops and specifies the indirect subsidy concept already present in the General Agreement. Similar remarks can be made for the extension of loans on preferential terms by government or on governmental behest, as well as with equity provision to state-owned firms. However, in this case the United States outlook, which focuses on consistency with market parameters, does not coincide with the perspective of other GATT parties.

With regard to material injury the implementing US legislation is much more detailed and complex than its multilateral counterpart. In some key points, however, relevant divergences emerge between the two sets of rules, as in the case of the causation process between subsidies, exported merchandise, and their impact on the domestic industry. Also the concept of cumulation is not present in the multilateral regulation of injury.

The foregoing sections bring us to the question of whether the US statutes since the 1979 TAA and their implementation represented a drift towards protectionism.

The analysis of US laws, administrative practice, and case law does not bear out a radical change in that direction in the institutional setting. Firstly, the US law was mostly in line with the General Agreement and the Subsidies Code.

Secondly, the US's most prominent additions to multilateral rules, such as specificity, were advantageous to foreign exporters. Thirdly, the introduction of the material injury test meant, at least at first sight, a tardy fulfilment of international commitments.

The devil is in the detail and the role of each of the three actors - lawmakers, Executive, and courts - in causing that evil is not uniform.

As regards specificity, it was the Executive that adopted a free market stance through the "general availability" approach. The Court of International Trade gave a more restrictive interpretation to the law, and Congress codified the CIT's perspective by adding a new subsection to section 701 (5).

As far as upstream subsidies are concerned, Commerce and the CIT interpreted the rules in a non-protectionist way. Only later the administering authority adopted a more protectionist stance to support a particular sector of the economy, agricultural produce and its processed output, and this approach was codified by Congress. It should be noted that a protectionist bias becomes quickly more pronounced when the need arises to protect domestic industries that find themselves at a disadvantage which they blame on government support for foreign competitors.

With regards to government supported loans and to equity capital infusion in state-owned companies, the American viewpoint, whose landmark is the market, is probably more in line with economic analysis than its EC counterpart which makes subsidisation assessment conditional on a burden on the public budget. Reliance on the market as the only gauge to assess subsidies can, however, result in undue, that is, protectionist, penalisation of foreign competitors. This can be said for the later abandoned equalisation of loans on preferential terms to uncreditworthy companies to equity provision, which was the approach followed by the ITA in the early stage of the steel cases. The same can be said of equity capital infusion in loss making state-owned companies, where the decision to invest, which can be perfectly consistent with commercial consideration, becomes countervailable if the owner happens to be a government or a public authority.

As regards the material injury test, the divergence with the Subsidies Code wording over the role of subsidy and exported merchandises in the injury to domestic industry causal process makes an injury determination much easier in the United States. Cumulation introduced, or at least codified, by the 1984 Act adversely affects foreign exporters. Here Commerce would have preferred a less protectionist approach but its leeway was limited by lawmakers. The latter, however, in the 1988 Omnibus Trade and Competitiveness Act tried to limit the worst abuses of its creature.

In short, the implementation of multilateral law, which can be considered a drift towards a less unilateral regime, was accompanied by a multitude of unholy details. We leave unanswered the question as to whether these details changed the institutional setting in a protectionist direction "by cumulation".

# CHAPTER IV

## US TRADE POLICY AND THE WTO SCM REGIME AS INTERPRETED BY THE WTO JURISPRUDENCE

### Introduction

In the previous chapters we have examined the developments in US legislation and practice on CVD measures and the various phases of the international regulation of subsidies and countervailing measures culminating with the Tokyo Round Subsidies Code. This chapter tries to answer the question whether the results of the Uruguay Round reflected or departed from the objectives pursued by the United States and the pattern that had emerged in its countervailing duty regime.

The United States pressed for much stronger discipline on subsidies, as well as measures having similar effects, arguing that they, in most forms, if not all, distort resources allocation and hamper economic efficiency, while most of the other participants viewed countervailing measures as the main culprit, considering it a covert protectionist tool.[1] Depayre has a point in noting that the negotiating parties' outlooks were for so long opposed and it was so difficult to find a common ground that in the end the standstill was overcome only through the provision of draft texts, first by the Chairman of the Subsidies group and later by the GATT Director General, Dunkel[2]; and it is arguable that such draft texts were not the exact balance of the contrasting viewpoints of the participants. However, the United States was not alone in asking for more stringent and wide-ranging rules to contrast the use of subsidies. Indeed, the Uruguay Round history

[1] Patrick J. McDonough, "Subsidies and Countervailing Measures", in Terence P. Stewart, ed., *The Uruguay Round. A Negotiating History (1986-92* (Deventer:Klewer Law and Taxation Publishers, 1993), p.854.
[2] Gérard Depayre, "Subsidies and Countervailing Measures after the Uruguay Round: an Overview", in Jacque H.J. Bourgeois et al., ed., *The Uruguay Round Results: A European Lawyer's Perspective* (Brussels: European Interuniversity Press, 1995),p.249.

shows that many proposals that reflected established US practice were put forward by other parties to the General Agreement belonging to the industrial world, while, perhaps for tactical reasons, the United States seemed to have had second thoughts on the usefulness of including in the Agreement some cornerstones of its most recent countervailing measures regime, the most striking example being the US doubts on the inclusion of the specificity test in the final text.[3] On the other hand, history and, therefore, the difficult balance between contrasting interests and outlooks did not stop with the end of the Round. Firstly, some pivotal provisions of the SCM Agreement, such as those concerning non-actionable subsidies, were "de facto" repealed as they were not extended after the five year term provided by the article on provisional application. Secondly, the contribution of the WTO case law has been of particular importance in shedding light on, and quite often closing the loopholes of, the SCM text.

The research, therefore, focuses on the stance of the United States in the Uruguay Round and on its links with practice and doctrine developed in the US. And compares it with the Uruguay Round results, that is, the text that emerged from the negotiations, especially as interpreted by the WTO jurisprudence. The analysis, thus, concentrates on those aspects of the new multilateral SCD regime that are particularly relevant for the comparison, such as the identification of what constitutes a subsidy; the classification of subsidies; the identification and discipline of export subsidies and import substitution subsidies and the legal relevance of the illustrative list with particular reference to export credits; the actionable subsidies regime; and finally the countervailing duty multilateral discipline. The question as to whether the WTO rules, as applied by the DSU bodies, has prevalently restricted or widened the importing countries' room for

[3] Patrick J. McDonough, Subidies, op.cit., p. 900, note 526.

manoeuvre, thus allowing exploitation for protectionist goals, is mainly left to chapter VII after an analysis of the post- U.R. US regime carried out in the same light.

**1)The Uruguay Round Negotiations on subsidies and countervailing measures: issues on the negotiating table and the parties' perspectives**

One of the main omissions of the Tokyo Round Subsidies Code, along with the General Agreement, was the definition of what constitutes a subsidy. The participants to the Uruguay Round had to address this problem as "the inevitable first step on the road to agreed rules and disciplines".[4] Indeed the definition of subsidy and the factors that originate it appeared instrumental in the assessment of subsidisation as well as in drawing the line between different categories of subsidies. Two opposite philosophies clashed. The United States supported, in keeping with its domestic practice, the benefit to recipient approach, arguing that injurious subsidisation should be looked at from the perspective of competing industries in the importing country. For these industries costs borne by the subsidising government in providing funds were irrelevant, as what really mattered in economic terms was the economic benefit for the recipient. Other participants supported the cost to government approach, pointing out that the former method could lead to abnormal results as the subsidy found could be much higher than the subsidy actually paid. In their view, the approach suggested by the United States could even result in the finding of subsidisation where no subsidy had been granted.[5] As a logical development of the benefit to recipient approach, the United States also suggested that so-called private subsidies, wherein benefits

[4] Jacques Bourgeois, "The GATT Rules for Industrial Subsidies and Countervailing Duties in the New Round. The Weather and the Seeds", in Ernst-Ulrich Petersmann and Meinhard Hilf, eds., *The New Gatt Round of Multilateral Trade Negotiations. Legal and Economic Problems* (Deventer: Kluwer Law and Taxation Publishers, 1995), p. 228

[5] See Uruguay Round.Negotiating Group on Subsidies and Countervailing Measures. Meeting of 19-20 October 1989. MTN/GNG/NG10/14, para 5.

are conferred from private sources at the mandate of government, be actionable.[6] The US did not press, however, for a general definition of subsidy, which was instead the subject of an EC request. The definition provided by the United States referred specifically to domestic subsidy, although it was finally adopted as a general rule. Nor did the United States put forward any proposal for the adoption of any rule on specificity, which was pushed forward by Switzerland.

The second main question concerned the classification of subsidies and, therefore, their treatment. The United States adopted a pragmatic approach to the negotiations, aiming to enlarge as much as possible the scope of prohibited subsidies, by attracting some domestic subsidies, and impose more stringent rules on the remaining domestic subsidies. On the other hand, the United States tried to extend the safe harbour for sectors, like export credit, of particular interest for the United States. In its proposals the United States provided two categories of prohibited subsidies: export subsidies and trade related subsidies.[7]

As regards export subsidies – for which the American delegates did not suggest any definition, thus, implicitly accepting the rather open-ended wording of GATT 1947 Art. XVI and of the Tokyo Round Subsidies Code, referring to the simple fact that exported goods are subsidised – the United States proposed some modification to strengthen their discipline, calling in particular for the prohibition of governmental provision of exchange rate risk insurance or insurance against increases in the cost of exported goods. On the other hand, the United States suggested that the exclusive reference to "interest rate" in item (K) of the list attached to the Tokyo Round Subsidies Code be deleted, so that lending practices,

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[6] See Patrick McDonough, Subsidies, op.cit. p.899.

[7] Uruguay Round.Negotiating Group on Subsidies and Countervailing Duties. Communication from the United States. MTN/GNG/NG10/W/20 (June 5,1988).
Uruguay Round.Negotiating Group on Subsidies and Countervailing Duties.. Elements of the Framework for Negotiations. Submission from the United States. MTN/GNG/NG10/W/29 (November 22, 1989).

conform in all respects to the provisions of the international undertaking on official export credits, which, obviously would increase the scope of the safe harbor provision for those countries participating to the OECD Arrangement.

The new category of prohibited subsidies, envisaged by the US, i.e. trade-related subsidies, included those subsidies conditional on the use of domestic rather than imported goods, or the fulfillment of a local content requirement, or the attainment of certain net surpluses, as well as subsidies to firms predominantly engaged in export trade and, finally, domestic subsidies exceeding a given percentage of the firms' total sales.[8] The first subgroup had already attracted the attention of US lawmakers and scholars as they affected the position of the United States both as exporter and investor.[9] For instance, the subsidiary of a multinational corporation could find it convenient, according the economic logic of the group, to purchase goods from its parent company, but if it wanted to receive a subsidy, it would be compelled to opt for domestic sources of supply; even more so if, as often happens, the subsidy were part of a package which had as its dominant component the permission to invest in the host country. With regard to the second subgroup the United States justified its request arguing that subsidies to firms that are engaged predominantly in exportation will necessarily have effects similar to export subsidies and, hence, like export subsidies, should be prohibited. For the third group the United States pointed out that big subsidies necessarily distort the allocation of resources and the commerce that results from those resource allocations.

In a subsequent stage the United States also called for the banning of a set of subsidies that it deemed bound to result in a net cost to government, such as grants

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[8] MTN/GNG/NG10/W/29 (November 22, 1989) Sect.I
[9] See C.G.B. Fontheim and R.M.Gadbaw, "Trade-Related Performance Requirements under the GATT – MTN System and U.S. Law", *Law & Pol'y Int'l Bu,* 14(1982) *p.* 131.

to cover operating losses, direct forgiveness of debts, provision of equity capital with an expected rate of return lower than the cost of obtaining funds and administering the investment, loans at interest rates lower than the government's cost of obtaining the funds and administering the loans, and loan guarantees with premium rates insufficient to cover the mentioned costs.[10]

Two kinds of remedies were suggested against prohibited subsidies. On the one hand, the imposition of countervailing duties on subsidized imports equaling the amount of subsidy. No mention of material injury was made. On the other hand, the initiation of a multilateral review of the contested practice aimed at prompt elimination of the programmes granting a prohibited subsidy. If the programmes were not eliminated within a reasonable time period countermeasures should be authorized.

The United States claimed that the identification of actionable subsidies implies their definition and their assessment. Subsidies would result from any government action or combination of government actions that confers a benefit on the recipient firm, while actionable subsidies would be all subsidies that are not prohibited or non-actionable. Consequently, the value of a subsidy, and of an actionable subsidy in particular, was to be measured by reference to the benefit to the recipient. [11] The importing country would be authorised to impose countervailing duties, subject, however, to proof of material injury, while in the multilateral context the first obligation of the subsidizing country would be to terminate the violative programmes immediately upon a finding of adverse effects. If they were not terminated promptly, the complaining country might

[10] Uruguay Round.Negotiating Group on Subsidies and Countervailing Duties. Elements of the Negotiating Framework. Submission from the United States. MTN GNG/NG10 W 39 (27 September 1990).
[11] MTN/GNG/NG10/W 29 (November 22, 1989) Sect.II

demand compensation or seek authority to retaliate according to the adverse effect.

During the better part of the negotiations the United States was rather doubtful of any justification for an exempted, or green light, category, pointing out that the fungibility of money makes it possible to channel funds apparently destined to unsuspected goals towards sectors and forms of production that can have trade- distorting effects. Besides, in the US opinion, the creation of an exempted category could prove an incitement to rename subsidies so that they can move from the prohibited to the non-actionable category.[12] Only after the stalemate in the December 1990 Brussels Conference, did the Bush Administration seem prepared to consider a limited and carefully controlled allowance for green light subsidies. Things changed, though only with regard to one green light sub-group, R & D, when the Clinton Administration took over and the United States even pressed for an increase of the ceiling for Research and Development spending over the threshold established in the Dunkel Text.[13]

In contrast, the European Communities along with most other industrialised countries contended that a wide range of government support practices should be considered non-actionable. In particular the Community, together with Canada, Switzerland, the Nordic Countries and Japan, suggested that, apart from generally available programmes, governmental aid for research and development as well as regional development assistance constitute non-actionable subsidies. The EC also suggested that aids to energy savings should be

[12]MTN/GNG/NG10/W/29 (November 22, 1989) Sect.III.

[13] See George Kleinfeld and David Kaye, "Red Light, Green Light. The 1994 Agreement on Subsidies and Countervailing Measures, Research and Development Assistance, and US Policy, *J.W.T.*, 28(1994), n.2, p.44.
The change in attitude by the US as regards the treatment of R&D subsidies casts further doubts on the assumption that the efficiency rationale underpins the SCM Agreement. Indeed, it is difficult to argue that this kind of subsidy does not significantly affect the competitive edge of their beneficiaries in the international market, at least as long as there is no substantial spill-over to other competitors.

non-actionable, while Switzerland and the Nordic Countries made a more wide-ranging proposal, encompassing the exception of environmental schemes.[14]

The United States tried to preserve its leeway in countervailing duty proceedings and, along with Australia, Switzerland and the Nordic Countries, suggested that the importing country be allowed to take action against prohibited subsidies without proof of injury. It also argued in favour of extending the scope of countervailing measures where subsidies cause adverse effect in third country markets and in the home market of the subsidising government.[15] Other countries, both industrial and developing, strove to counter the US attempt by stressing the need for a more flexible and, at the same time, more detailed regulation of countervailing measures. In particular, the European Community opposed the elimination of the serious injury test and called for a public interest clause for the imposition of countervailing measures, consequently suggesting that the amount of countervailing duties should be lower than the subsidy amount if the lesser duty were able to remove injury.[16]

The initiative to bridge the gap between the conflicting outlooks of the negotiators was taken by the GATT Secretariat in 1991. As pointed out by the Director-General of GATT himself, the Draft Final Act Embodying the Result of the Uruguay Round Multilateral Trade Negotiations, subsequently better known as the Dunkel Text, was the outcome of "both intensive negotiations and of arbitration and conciliation", the latter being provided with the aim of striking the best possible balance across the board of the whole Uruguay Round agenda.[17]

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[14] Patrick J. McDonough, Subsidies, op.cit., p. 904.
[15] Ibid., p. 891.
Uruguay Round.Negotiating Group on Subsidies and Countervailing Duties.Communication from the EC. MTN/GNG/NG10/W/7 (June 11,1987).
[16] Patrick J. McDonough, Subsidies, op.cit., p. 847.
[17] See John Croome, *Reshaping the World Trading System* (Geneva: World Trade Organization, 1995), p. 293.

With regard to subsidies the "draft final act" was reproduced largely unchanged in the final SCMA text.

**2) The SCM Agreement text as interpreted by the WTO panels and the Appellate Body and its consistency with the US perspective and goals.**

In contrast with the Tokyo Round Subsidies Code and in line with the General fabric of the WTO Agreement, the Subsidies and Countervailing Duty (SCM) Agreement is binding on all WTO members. Like the Dunkel Text, the SCM Agreement is divided into eleven parts and has six Annexes. The first five parts lay out the basic rules of the Agreement: Part I defines the term "subsidy" and the concept of specificity. Parts II, III and IV divide subsidies into three categories: prohibited, actionable and non-actionable. Part V establishes the substantial and procedural requirements for the imposition of countervailing measures. Parts VI and VII concern the institutions specifically charged with the administration of the agreement and the arrangements for notification and supervision. Parts VIII and IX lay out differential provisions for various categories of developing countries and for countries in the process of transformation into a market economy. Part X deals with dispute settlement and Part XI contains final provisions.

As is usual with international agreements, the SCM Agreement sometimes leaves out the definition of some concepts, or fundamental parts of them, which are pivotal in implementing the text. The battle of ideas and interests and, therefore, the effective prevalence of the outlook of a member over those of its trading partners are, thus, fought within the framework of the Dispute Settlement mechanism.

*1)Relation between the SCM Agreement and GATT 1994*

A preliminary question concerns the relationship of the SCM Agreement with Arts. VI and XVI of GATT 1994. The question was examined by a WTO panel and by the Appellate Body in a case referring to the applicability of the SCM Agreement to countervailing duty investigations started prior to the entry into force of the Agreement. In the "Brazil – Desiccated Coconut" case, which originated from the imposition of countervailing duties by Brazil against imports of the desiccated product from the Philippines, the defendant, Brazil, contended that only the provisions of the Tokyo Round Subsidies Code were applicable to the dispute, and that no provision of GATT 1994 could be invoked. In this context the WTO panel entertained the question of whether Article VI of GATT 1994 creates rules which are separate from those of the SCM Agreement, and which can be applied without reference to that Agreement. The panel and later the Appellate Body based their answer on Art. 10 and Art 32.1 of the SCM Agreement. The first provides that the imposition of a countervailing duty must be in accordance with the provisions of Article VI of GATT 1994 and the terms of the Agreement, while the second requires that no specific action against a subsidy be taken except in accordance with the provision of GATT 1994 as interpreted by the SCM Agreement. The Appellate Body, affirming the conclusion reached by the panel, held that the ordinary meaning of these provisions taken in their context leads to the conclusion that the negotiators of the SCM Agreement clearly intended that, under the integrated WTO Agreement, countervailing duties may only be imposed in accordance with the provisions of Part V of the SCM Agreement and Article VI of the GATT 1994, taken together. On the other hand, if there is a conflict between the provisions of the SCM Agreement and Article VI of GATT 1994, the provisions of the SCM Agreement would prevail as a result of the general interpretative note to Annex 1A.[18]

More uncertain is the relationship between the SCM Agreement and Art. XVI of GATT 1994. Some commentators have gone so far as to assert that "the regime established by the Subsidies Agreement is of such width and complexity that it leaves little if any room for the operation of the scheme established by GATT Article XVI".[19] Certainly the general principle of the inseparable package of rights and disciplines applies. However most of the provisions of Art. XVI, such as the double price criterion or the vague category of export subsidies, are rendered obsolete by the detailed regulations of the new Agreement, and, therefore, fall within the scope of the "general interpretative note". On the other hand, Art. 1.1 of the SCM Agreement in defining the core of its regime expressly refers to GATT Art. XVI with regard to "any form of income and price support".

Recognition in principle of the unbroken validity of article XVI of GATT could be found in the Foreign Sales Corporations (SCM) case where, as we shall see in greater detail in the following chapter, the US argued, among other things, that Art. XVI and the 1981 Understanding following the adoption of the DISC panel reports were relevant in interpreting certain provisions of the Agreement. Here the panel stated that, in principle, article XVI of GATT 1994 has not ceased to be legally operative and that "the SCM Agreement and article XVI are not to be construed in isolation from each other". However, the SCM decision does not illustrate the general point, as the panel also held that in the case in question the language of the SCM Agreement to be interpreted in the dispute had no

[18] Brazil – Measures Affecting Dessiccated Coconut-AB1996-4- Report of the Appelate Body (21.7.1997)). WT/DS22/AB/R, para.E, 2
[19] Edmond McGovern, *International Trade Regulation* (Exeter, Globefield Press, 1995) p. 11.38-1.

counterpart in article XVI:4 of the GATT and, therefore, the latter had no bearing in its interpretation.[20]

*2) Subsidy definition*

For the first time in over forty years Art. 1 of the SCM Agreements fills the main conceptual gap in the subsidies and countervailing measures discipline by providing a definition of subsidy. The definition contains two basic elements:

A) A financial contribution provided by a government or a public body within the territory of a WTO member.[21] Reference to public bodies within the territory of a member implies that the Agreement does not only cover the actions of national governments but extends to sub-national governments and even to state-owned companies. The contribution can take various forms:

1) a government practice which involves direct transfer of funds (e.g., grants, loans and equity infusion) or potential direct transfer of funds along with the underwriting of liabilities (e.g. loan guarantees);
2) remission of otherwise due government revenue;
3) provision of goods and services other than general infrastructures, or purchase of goods;
4) situations where a government makes payments to a funding mechanism or entrusts a private body to provide a direct contribution.

In addition the Agreement applies where there is any form of income or price support under Art. XVI of Gatt 1994.[22]

B) A benefit to the recipient.[23]

[20] See Marc Benitah, *The Law of Subsidies under the GATT WTO System* (Hague: Kluwer Law International, 2001), p. 158.
[21] Art. 1.1(a)(1)
[22] Art. 1.1 (a)(2)
[23] Art. 1.1 (b)

A first comparison between the text of SCMA Art. 1 on the one hand and the outlook of the United States and its opponents, on the other, shows much greater proximity with the US perspective. Indeed Art. 1 by providing for a financial contribution or a form of price and income support, which confer a benefit has strong similarity with the American proposal, according to which subsidies result from a government action or combination of government actions resulting in a benefit. In contrast the charge to the budget principle is not a necessary component. Certainly, release of government revenue implies by necessity a net cost for the public budget, but this is not so for the other hypotheses of financial contribution. For instance, the provision of goods for which appropriate consideration is received does not result in a charge for the budget. Facilitated loans do not entail a net cost if the interest and other charges paid by the private borrower are higher than what is paid by the public body to obtain the funds. Price and income support schemes can be easily financed by sources other than the public budget.

The SCM text, however, does not provide a definition of what constitutes benefit. Besides some hypotheses of financial contribution lend themselves to contrasting interpretations. The task of shedding light, or rather to give meaning to the wording of the article was, therefore, left to the panel and the Appellate Body.

*Benefit*

In "Canada -Aircraft" the WTO panel focused on the interpretation of the term "benefit". Its interpretation, however, also sheds light on the identification of the first component of the term "subsidy", that is, financial contribution. The complainant, Brazil, alleged that some benefits granted by Canadian national and provincial authorities constituted subsidies contingent on export performance and, therefore, were in violation of Art. 3.1(a) of the SCM Agreement. The measures complained about by Brazil were financing and loan guarantees provided by the Export Development Corporation, which included liquidity infusion for corporations specially established to assist the export of civil aircraft, funds provided by Technology Partnership of Canada, and various benefits provided by provincial authorities.

Obviously, violation of Art. 3.1 posits the existence of a subsidy, which implies financial contributions and benefit. The defendant, Canada, argued, however, that benefit had two components: the first is an advantage; the second a net cost to government. In defence of its thesis Canada argued that if we rely just on the ordinary meaning of benefit, the scope of the term benefit would be too broad as it could include normal commercial activity, such as a commercial contract entered into by a government that accords an advantage to a firm. Its meaning must, therefore, be restricted by taking into account the cost to the granting government. This approach, in Canada's opinion, was supported by the fact that paragraph 1 of Annex IV to the SCM Agreement (concerning total ad valorem subsidisation for the purpose of establishing a presumption of serious prejudice under art 6.1 of the Agreement) provides that "any calculation of the amount of a subsidy... shall be done in terms of the cost for the granting government".[24]

The question that immediately arises is why Canada resorted to such a daring and convoluted interpretation of Art. 1.1(b) of the SCM Agreement. The likely explanation is that Canada believed that its system of financial support did not imply a burden to the budget – as the export credits were not provided at rates

[24] Canada – Measures Affecting the Export of Civilian Aircraft. Report of the Panel (14.4.1999) WT/DS70/R, paras. 5.31-5.38.

below the cost of funding paid by governmental financial institutions - but feared, rightly, that the absence of a net cost was not relevant under the heading of the first part of Art. 1.1(a), that is, financial contribution. As noted above under Art. 1.1(a)(1) what is needed is only a direct transfer of funds (e.g. grants, loans, and equity infusion) and Canada could not deny that it had lavishly provided the programmes in question. The only way to give relevance to the absence of cost to the budget, therefore, was to try to find a link with the existence of a benefit.

The panel, whose report was upheld by the Appellate Body, firmly withstood such an attempt, noting that the ordinary meaning of benefit encompasses some form of advantage but does not "per se" include any notion of net cost to government. The only thing needed to determine the bestowing of benefit is whether "the financial contribution places the recipient in a more advantageous position than would have been the case without the financial contribution"; and, in the panel's view, the yardstick is the market.[25] The panel found support for its viewpoint in Art.14 of the Agreement, which provides guidelines for "calculation of the amount of subsidy in terms of the benefit to the recipient". The panel pointed out that, although the article expressly applies to countervailing measures, regulated in part V of the Agreement, by referring to Art.1.1 it acquires wider scope serving as a relevant context for determining when a benefit arises, no matter the remedy that is ultimately applied.[26] On the other hand, the panel did not accept Canada's suggestion that Annex IV of the SCM Agreement should be taken into account, as its goal was just the identification of

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[25] WT/DS70/R, paras 9.112, 9.115.
[26] Ibid., para.9.113.

serious prejudice, i.e. a particular hypothesis of actionable subsidy, whereas benefit was the hardcore of subsidy assessment.[27]

Finally, in line with what we have noted above, the panel argued that the inclusion of net cost to government in the notion of benefit could exclude from the notion of a subsidy situation explicitly identified in Art. 1.1(a), though it specifically referred only to situations where a government directs a private body to make a financial contribution, noting that in such a case "the net cost could be incurred entirely by the private body".[28]

The report gainsaid the viewpoint of some commentators of the SCM text at an earlier stage. Collins-Williams and Salembier had argued that, though the concept of benefit is related to the provisions of Art. 14 on the calculation of the amount of a subsidy, the latter concerned only countervailing measures.[29] Such an interpretation would cause the splintering of the conceptual framework of the Agreement, thus contradicting one of the major aims of the negotiations, which was to concurrently address subsidies and countervailing duties. Indeed, as its heading makes clear, article 14 sets the criteria to measure the amount of subsidisation with reference to the benefit for the recipient and, in its turn, the yardstick for the latter is the difference between what is offered and requested by the market and the conditions available to the recipient enterprise as a result of government intervention. It would be rather odd to confine the identification of benefit in Art. 14 to countervailing measures, leaving the question open to contrasting solutions where other remedies, i.e. multilateral remedies, are concerned.

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[27] Ibid., para. 9.116.
[28] Ibid., paras. 9.111-9.116.
[29] Terry Collins-Williams and Gerry Salembier, "International Disciplines on Subsidies. The Gatt, the WTO and the Future Agenda", *J.W.T., 30 (1996) n.1*,p.10.

It must be noted, at any rate, that reference to the market, whatever its type, does not cover all forms of benefit. That is, the benchmark can vary according to the kind of financial contribution from which it derives. In particular, as we shall see in detail in the following chapter, as regards the forgoing of government revenue, benefit is not assessed with reference to the market but with reference to the burden that would more generally apply, absent the measure under investigation.

*Financial contribution*

The first component of the term "benefit", financial contribution, has been examined with reference to the US attempt to widen the hypothesis of provision of goods and services and the hypothesis of entrustment of governmental function to private bodies to make them consistent with US domestic legislation.

In "US - Export Restraints" Canada complained to the WTO about a provision of the US countervailing duty law that treated restraint on exports of a product as a subsidy to other products using or incorporating the restricted product if the domestic price of the restricted product is affected by the restraint. The United States argued that export restraints could, at least in some factual circumstances, constitute a government-entrusted or government-directed provision of goods by a private body in the sense of Art. 1.1(a)(1)(iii) and (iv) of the SCM Agreement. The US contended that if a limitation or prohibition of export compels a producer to sell in the domestic market, it results in increasing supply and, thus, in a lower equilibrium price. Therefore, it confers a benefit on domestic users of the product.[30] In such a case, for the US, limitation or

[30] United States – Measures Treating Export Restraints as Subsidy. Report of the Panel ( 29.6.2001). WT/DS194, para. 8.26

prohibition of export is only semantically different from an affirmative direction to a private entity to provide goods to domestic producers.[31] As noted by the panel this approach reflected US administrative practice which treated as countervailable benefits arising from government action, regardless of the nature of that action.

The panel did not follow this course, holding that the terms "entrust and direct" in the text of the article clearly imply an affirmative action by the government, which entails three elements: 1) a delegation or command; 2) addressed to a particular party: 3) the object of which is a particular task or duty.[32] This situation, in the opinion of the panel, is very different from ordinary governmental intervention in the market, with various policy objectives, which have various results, some of which are not intended or even desired by the government.[33] Thus, in contrast with the US approach the existence of a financial contribution does not depend on the reaction of the producer of the restrained good; rather it must be proven by reference to the action of the government.

It must be noted, however, that the US was not requested to repeal or amend the relevant section, 771(5), of the Trade Act of 1930 as amended by the Uruguay Round Agreements Act, as the statute was to be read in the light of the Statement of Administrative Action (SAA) which permits but does not expressly require the treatment of export restraints as financial contributions in countervailing investigations. Therefore, only countervailing measures in individual cases could be reviewed according to the above- developed reasoning.

[31] Ibid., para.8.27.
[32] Ibid., para 8.29.
[33] Ibid.,para. 8.31

### 3)*Specificity*

Art. 2 of the SCM Agreement introduces a specificity requirement which tracks the US model. Specificity can be either "de iure" or "de facto". In the former case a subsidy is specific if the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises. The subsidy, however, is not "de iure" specific if eligibility is based on explicit, verifiable, objective criteria, i.e., not favourable to certain enterprises over others.

On the other hand, even if the subsidy is not specific by law but there are reasons to believe that the subsidising programme may in fact be specific, other factors may be considered, which closely correspond to those used by the United States in the previous decade. They include the exclusive, or predominant, use of a subsidy programme by a limited number of enterprises, the granting of disproportionately large amount of subsidies to certain enterprises and the exercise of discretion by the granting authority. Some American scholars have noted, however, that the SCM article provides for certain factors that were not considered by preceding US practice.[34] In particular, the Agreement provides that the investigating authorities should take into account the diversification of economic activity in the subsidising country and the length of time the programme has been in operation. The first requirement may prevent the finding of specificity for a developing country's programme if its economy is not diversified. The longevity of a subsidy programme may also prevent the finding of specificity

[34] Gary N. Horlick and Peggy A. Clarke, "The 1994 WTO Subsidies Agreement",*W.Comp.*,17 (1994), 4, p. 43.
M.Jean Anderson and Gregory Husisian, "The Subsidies Agreement", in Terence P. Stewart, ed., *The World Trade Organization:the multilateral trade framework for the 21st century and U.S. implementing legislation* (Washington D.C.: American Bar Association-Section of International Law and Practice, 1996),p.308.

because the programme is too new to be used by a large number of enterprises. Finally, in contrast with previous US practice, Art.2.4 provides that "any determination of specificity ...shall be clearly substantiated on the basis of positive evidence", thus establishing a presumption of non-specificity unless proof of its occurrence is given by the investigating authority.[35]

Art. 2 establishes two instances in which subsidies are deemed to be specific: export and import substitution subsidies, defined in Art. 3 of the Agreement, and regional subsidies. With regard to the latter it must be remarked that the US obtained a last minute victory as the text of the SCM Agreement on this point represents a significant departure from the Dunkel Draft. Indeed, whereas according to the Dunkel Text "a subsidy which is available to all enterprises located within a designated geographical region shall be specific irrespective of the granting authority", Art. 2.2 of the SCM Agreement provides that subsidies "limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific". This slight change in the text makes non-actionable those subsidies granted by federal states or provinces on a generally available basis within their territory. This is in line with US rules and thus creates, in spite of geographical coincidence, a disparity between subsidies granted by local authorities and subsidies bestowed by national authorities to economic initiatives located in a sub-national territory.

***4) Prohibited subsidies***

Following the Dunkel Text's pattern, the SCM Agreement has adopted the traffic light approach, as subsidies are divided into three categories: prohibited,

[35] Gary N. Horlick and Peggy A. Clarke, op.cit., p. 44.

actionable and non-actionable. Prohibited (red light) subsidies are those subsidies which are more clearly designed to affect trade and, therefore, to have adverse effects on the interests of other WTO members.

Art. 3 of the Agreement divides prohibited subsidies into two categories: subsidies contingent on export performance, whether in law or in fact and whether wholly or as one condition among several, and import substitution subsidies.

*Subsidies contingent on export performance*

Art. 3.1 (a) of the Agreement deals with subsidies contingent, in law or in fact, on export performance, whether wholly or as one condition among several. Subsidies that are not explicitel export subsidies nonetheless will be deemed export subsidies if they are in fact contingent on actual or anticipated export earnings.[36] On the other hand, a subsidy is not to be necessarily considered an export subsidy merely because it is granted to an exporting enterprise.[37] The main questions, therefore, concern the interpretation of what is meant by "contingent" and the distinction between "in law" and "in fact" subsidisation

In the "Australia - Automotive Leather II" case the United States suggested a rather broad interpretation of the term "contingent in fact on export". The case concerned the relevance of article 3.1(a) of the SCM Agreement with regard to a grant contract and a loan contract signed by the Australian government with the only dedicated producer and exporter of automotive leather in Australia, Australian Leather Holding Ltd, and its subsidiary, Howe. The grant subsidy provided for payments totalling up to a maximum of AU $30 million, to be paid in three instalments, the second and the third of which were made conditional on

[36] Art. 3.1(a), note 4.
[37] Ibid.

performance targets set out in the contract. The loan contract provided for a fourteen-year loan of AU $ 25 million, with a five-year grace period and interest rate below that prevailing in the financial market.

The United States argued that a subsidy can be contingent in fact on export even though actual or anticipated exportation is merely one of several potential criteria influencing the bestowal of benefits. According to the United States, the Uruguay Round had expanded the scope of a prohibited subsidy and rather than requiring that export performance be the "only" or the "most important" element, Article 3.1(a) provided that export performance might be either the sole contingency for the subsidy or merely "one of several other conditions". The export requirement therefore did not need to carry preponderant weight in the approval of benefits to qualify as an export subsidy. On the other hand, footnote 4 of the SCM Agreement did not preclude taking into account the impact on the level of exports, as it simply excluded that the finding of a prohibited export subsidy could be based solely upon the level of exports.[38] The defendant, Australia, contended that the facts must demonstrate that the granting of the subsidy is actually tied to export performance, i.e., actual or anticipated exportation or export earnings and, therefore, favours export over domestic sales".[39]

The panel solved the case without providing an in-depth conceptual framework, preferring a pragmatic approach. On the one hand, it argued that the determination of whether a subsidy is contingent in fact upon export performance requires an assessment of all the facts concerning the grant or maintenance of the challenged subsidy, including the nature of the subsidy, its structure and

[38] Australia – Subsidies Provided to Producers and Exporters of Automotive Leather. Report of the Panel (25.5.1999). WT/DS/126/R, para. 7.82.
[39] Ibid., para.7.85

operation, and the circumstances in which it is bestowed. It suggested, however, that taken together, the facts considered must demonstrate that the grant of the subsidy is conditional on actual or anticipated exportation or export earnings.[40] On the other hand, the panel noted that Art. 3.1(a) recognises that there might be multiple conditions for the granting of a subsidy, but "explicitly prohibits a subsidy if one of the conditions is that a subsidy is in fact contingent upon export performance".[41]

While recognising that the repayment of the loan was not conditional on export profits, the panel argued that the grant was in fact tied to Howe's actual or anticipated exportation or export earnings, because it was conditioned on the company's agreement to satisfy aggregate performance targets, which, given the export-dependent nature of Howe's business, and the size of the Australian market, were actually export performance targets.[42] Thus, the panel's opinion actually leads, partially at least, to the same results aimed at by the US proposals in the U.R. negotiations envisaging an extension of the prohibition to certain categories of trade related subsidies, among which those bestowed on firms predominantly engaged in export trade.[43]

The need for a direct link between the granting of a subsidy and exports is, however, clearly expressed in the above-mentioned "Canada-Aircraft" case, in which the Panel emphasised that there must be a clear connection, in the form of a finalistic relationship, between subsidy and exports. The Appellate Body, substantially upholding the Panel's report, argued that the term "contingent" implies a relationship of conditionality . This relationship is borne out by the wording of Art. 3.1(a) which states that "export contingency can be the sole or

[40] Ibid., para 9.57.
[41] Ibid., para.9.63.
[42] Ibid., paras 9.66-9.67 and paras. 9.74-9.75.
[43] See Section 1.

one of several other conditions".[44] In the opinion of the Appellate Body the legal standard expressed by the word "contingent" is the same for both "in law" or "in fact" contingency,. However, whereas "de iure" export contingency can be inferred from the wording of the relevant legal instrument, "de facto" export contingency "must be inferred from the total configuration of the facts surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case". To overcome this difficulty with regard to "de facto" export subsidies the word contingent must be read in conjunction with the wording of footnote 4, which provides that "the granting of a subsidy...is in fact tied to actual or anticipated exportation or export performance". In particular, according to the Appellate Body, the word "tied" underlines the link of contingency upon actual or expected exports. The need for such a link is further proved by the second sentence of footnote 4 which states that the sole fact that a subsidy is granted to exporting enterprises is not enough to make it a prohibited subsidy.

Consequently, the Appellate Body rejected the Canadian contention that a subsidy is contingent in fact upon export performance when the circumstances are such that the recipient would reasonably know that there is a requirement to export, as what is relevant is not the expectation of the beneficiary but the fact that public authorities make the granting of the subsidy conditional on export. Likewise, the expectation of an increase in exports is not enough to render the subsidy prohibited in the absence of a causal link between actual or foreseen exports and the granting of public aid.

It seems, therefore, that the Canada-Aircraft philosophy, in contrast to Automotive Leather II, is at loggerheads with the outlook underlying the US

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[44] Canada – Measures Affecting the Export of Civilian Aircraft. Report of the Appellate Body (2.8.1999). WT/DS70/AB/R, paras 166-174.

proposal on the prohibited subsidies discipline in the course of the Uruguay Round, which labelled subsidies as prohibited according to their presumed trade distorting effect, banning them "ex ante".[45] Indeed, the Appellate Body's opinion rejects unambiguously the "ex ante" approach, calling, instead, for a case-by-case analysis in which the examination goes well beyond the subsidy's effect and focuses on the subsidisation goal, that is, on the straight link between the bestowal of subsidy and trade performance.

The distinction between contingency "in law" and "in fact" was further explained in Canada-Autos. Under the Motor-vehicles Tariff Order (MVTO 1988) and the Special Review Orders (SROs), Canada – in line with Canadian obligations under the Canada-US auto pact, and later the CUSFTA and the NAFTA – granted import duty exemptions for automobiles, commercial vehicles and buses to foreign producers other than US firms, provided that they met specific value added ratio requirements. The Appellate Body, which upheld the panel's opinion, condemned Canada in the light of Art. 1.1 and 3.1(a) for giving up revenue that it could otherwise have raised, as it had ignored the normative benchmark it had established for import duties on motor vehicles under its normal MFN rate.[46] On this occasion the Appellate Body noted that "contingency in law can be demonstrated on the basis of the very words of the relevant legislation, regulation or other legal instruments", which sometimes expressly set out the conditions for the granting of the subsidy. It emphasised, however, that more often the condition to export can be implicitly comprised in the underlying legal

[45] See in particular, Negotiating Group on Subsidies and Countervailing Measures Meeting of 30November – 1 December 1989. MTN/GNG/NG10/15.
[46] Canada – Certain Measures Affecting the Automobile Industry . Report of the Appellate Body (31.5.2000). WT/DS139-142/AB/R, paras87-94.

instrument and, therefore, "can be derived by necessary implication from the words actually used in the measure".[47]

*Import substitution subsidies*

Art. 3.1(b) refers to subsidies contingent on the use of domestic over imported goods. The inclusion of such subsidies in the red-light category was a success for the US as prior to the Uruguay Round Agreement such subsidies had escaped direct prohibition and, therefore, it was necessary to prove that they caused serious prejudice. The achievement, however, risked being spoiled by a little omission in the text, whatever the real intention of its drafters. In contrast with article 3.1(a), Art. 3.1(b) contains no reference to "de facto" contingency. In the "Canada-Autos" case the panel, noticing the proximity of the two provisions, argued that the only reasonable meaning of the omission of such a reference is that the prohibition in Art. 3.1(b) extends only to "de iure" contingency.[48] That would have left the bulk of the subsidies in question out of the reach of remedies.

The Appellate Body overturned the panel's opinion. The opposite opinion of the Appellate Body, especially if viewed in the wider context of a case involving a review of some fundamental articles of GATT 1994 (i.e. Art. 1 and 3), as well as GATS Arts. I:1 and II:1 and the SCMA, has been considered as an example of the political power that the AB is naturally, if not explicitly, called to exercise. The AB's opinion has been viewed as an example of constructive interpretation of the text of WTO rules, reflecting legal-political concerns.[49] Indeed, the Appellate Body chose, as the panel, between two possible meanings of a text, or rather an omission in the text compared to related rules. The first

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[47] WT/DS139/AB/R – WT/DS142/AB/R, para. 100.
[48] WT/DS139/R – WT/DS 142/R, paras. 10.220 – 10.222.
[49] Niall P. Meagher,"The Sound of Silence: Giving Meaning to Omission in Provisions of World Trade Organization Agreements. A Note on The World Trade Organization Appellate Body Decision in United States – Countervailing Duties on Certain Corrosion Resistant Carbon Steel Flat Products from Germany", *J.W.T.*, 37 (2003), p. 427.

question, however, is whether the AB overstepped its powers in interpreting the text. The answer should be negative. In contrast to the apparently similar "US-German Steel CVD" case - analysed in detail in chapter VII, with regard to the presence of a "de minimis" threshold provision in the SCMA article addressing new investigations and its absence in the SCMA article concerning sunset review procedures - art. 3.1(a) of the SCM Agreement provides two alternatives under which an export subsidy can be ascertained, i.e., contingency in law and contingency in fact, while art. 3.1(b) is silent on both. Though accepting the panel's point of view that "omission must have some meaning" the AB, pointing out that omissions in different contexts may have different meaning, remarked in the first place that the text of Art. 3.1(b) is not conclusive as, if there is nothing that specifically includes subsidies contingent in fact, nor does the text specifically exclude them. The Appellate Body thus argued that the omission in the text of Art. 3.1(b) text was to be read not only with reference to Art. 3.1(a) but also in the wider context of the WTO multilateral agreements on Trade in Goods, noting that the panel's interpretation would make Art. 3.1(b) of the SCM Agreement conflict with Art. III of GATT 1994 (National Treatment on Internal Taxation and Regulation) which also addresses measures that favour the use of domestic over imported goods, without making any distinction between "de facto" and "de iure" causes of treatment inequality. Finally, the Appellate Body submitted that the exclusion of in fact contingency would run afoul of the purposes of the SCM Agreement, thus facilitating circumvention of the obligations .[50] It seems, therefore, that the Appellate Body adopted an extensive interpretation of the SCM text, without trespassing its borders, with the politically relevant aim of preventing the possibility that the discipline of Art. 3.1(b) could

[50] WT/DS139/AB/R – WT/DS142/AB/R. paras. 137-142.

be freely undermined by the use of subsidies contingent in fact on the use of domestic over imported goods.

The new hypothesis of prohibited subsidies had many point in common with the measures prohibited under the Agreement on Trade Related Investment measures and in particular with those envisaged by Item 1 of the Illustrative List annexed to the Agreement. Thus, as happened in the "Canada-Autos" case and in the "Indonesia Autos" case complaints were lodged against the same measures both under SCMA Art. 3.1(b) and under the TRIMs Agreement. In Indonesia Autos the analysis was provided with regard to a set of measures established by the Indonesian government to support production and marketing of cars in the Republic, some of which were conditional on the fulfilment of local content requirements. The panel considered the relationship between the Agreements reaching quite a restrictive conclusion. In particular, the panel argued that regarding local content requirements, the SCM Agreement and the TRIMs Agreement are concerned with different types of obligations and cover different subject matters, as the SCM Agreement prohibits the grant of a subsidy contingent on use of domestic goods, not the requirement to use domestic goods as such, whereas the TRIMs prohibits trade-related investment measures in the form of local content requirements, not the grant of an advantage, such as a subsidy.[51] Thus, according to the panel, inconsistency with SCMA Article 3.1(b) can be remedied by removal of the subsidy, even if the local content requirement remains applicable, while inconsistency with the TRIMs Agreement can be remedied by repealing the local content requirement even if the subsidy continues to be granted. Consequently, if the content requirements were dropped, the subsidy

[51] Indonesia-Certain Measures Affecting the Automobile Industry – Report of the Panel (2.7.1988). WT/DS 54/R., para. 14.50.

would continue to be subject to the SCM Agreement, although the nature of the relevant discipline under the Agreement might be affected.[52]

The panel's point of view, however, seems only partially correct, as it gives the idea that CSMA Art. 3.1(b) and the TRIMs agreement are just casual companions of a journey to different destinations, although on the same highway. As admitted by the panel, the relevant discipline under the Agreement might be affected and actually is deeply affected. Indeed, a subsidy conditional upon the use of domestic over imported goods is not only a subsidy, but a prohibited subsidy, which implies a non- rebuttable presumption of specificity and more stringent multilateral remedies than simple domestic subsidies, and the treatment applied by the SCM Agreement results from the subsidy in question being conditional on a trade-related measure, quite often aimed at promoting investments.

***5)The Illustrative List of Export Subsidies and the question of the relationship between the SCM Agreement and the OECD Arrangement on Guidelines for Officially Supported Credits.***

In chapter II we reported the controversy on the relationship between the Tokyo Round Subsidies Agreement and the Arrangement on Guidelines for Officially Supported Credits between the industrial countries which are members of the Organisation for Economic Cooperation and Development (OECD). The controversy was triggered by the inclusion in the export subsidies list of an item, k, which, though indirectly, referred to the OECD Arrangement, creating a safe harbour for those credits whose interest rates are consistent with the Arrangement's interest rate provisions. The quarrel has reappeared under Annex I to the SCM Agreement providing an illustrative list of export subsidies, among

[52]Ibid., para. 14.51.

which item (k) reproduces the provisions of the Subsidies Code. The disputes, at the centre of which have been some Brazilian and Canadian programmes designed to support civil aircraft exports, concern the following points: 1) the impact of the OECD Arrangement on the SCM Agreement. 2) the individuation of the relevant articles of the Arrangement. 3) the fate of those export practices which do not meet one of the conditions for the ban set out in an item of the list, but which are not explicitly excluded by the wording of any item.

Most of the above-listed contentious points are exemplified by the Brazil-Aircraft case. The dispute hinged upon certain export subsidies granted under the Brazilian Programa de Financiamento às Exportações (PROEX), under which the government of Brazil provided interest rate equalization subsidies for sale by Brazilian exporters, including an aircraft company, Embraer. Under the scheme the Brazilian lending bank that provided a buyer credit to assist the sale of Brazilian aircrafts charged its normal interest rate for the transaction, but received payment from two sources - the purchaser and the Government of Brazil. In this way, the export programme reduced the purchaser's financing costs and, thus, the overall cost of buying an Embraer aircraft.[53]

Before proceeding, it must be briefly remembered that the so-called commercial interest reference rates (CIRRs) had replaced in the course of the 1980s the matrix system, which provided minimum subsidised interest rates varying according to the per-capita income of the importing country, in an effort to create a more level playing field for the participants in the OECD Arrangement, which are industrial countries and some newly-industrialised countries, and to bring interest rates for officially supported credits closer to the market.

[53]In particular, the Brazilian interest equalization programme provided that the National Treasury grant to the financing party an "equalization payment" to cover, at most, the difference between the interest charges contracted with the buyer and the cost to the financing party of raising the required funds.

The present Arrangement, therefore, provides that CIRRs should closely correspond to the rate for first class domestic, as well as foreign, borrowers and should not distort competitive conditions.[54] To achieve this end, unless the participants to the Arrangement have agreed otherwise, CIRRs shall be set at a fixed margin of 100 basis points above their respective base rates, the latter being equal to the yields of various long-term bonds in the national currencies of the country providing the credit. A special regime however, is established for the Japanese Yen.[55]

The Arrangement allows the participants to match credit terms and conditions, whether notified or not notified, as well as credits supported by non-participants. In such cases the terms and conditions for the matching may not comply with the Arrangement if the initiating bid is not in compliance with it either.[56]

Brazil as defendant contended that, although PROEX payments were export subsidies, they were nevertheless permitted by the first paragraph of item (k) of the Illustrative List of Export Subsidies. Brazil argued that pursuant to item k, such payments are prohibited only "in so far as they are used to secure a material advantage in the field of export credit terms", and that “a contrario” such payments are permitted in so far as they are not used to secure a material advantage in the field of export credit terms." In Brazil's opinion, PROEX payments did not secure a material advantage in the field of export credit terms, because they were merely used to offset the so-called "Brazil risk" that made the provision of credit to Brazilian firms more costly than Canada's subsidies to Bombardier, Embraer's Canadian competitor, which was one of the major

[54] Arrangement on Guidelines for Officially Supported Credits (1998) article 15.
[55] Ibid., Art. 16.
[56] Ibid., Art.29.

beneficiaries of the programmes referred to in the Canada-aircraft case.[57] Therefore for Brazil, the absence of material advantage rose from the need to offset the higher cost of credit for developing countries (and Brazil in particular) and by the need to match the subsidies bestowed by the Canadian government to Bombardier, which affected, along with the interest rates and the duration of the loans, that is the financial package, the price of the aircrafts. Thus the idea of permitted matching for Brazil differs from the technical meaning of the OECD Arrangement as it goes beyond the financial terms of the bid.[58]

Until now the United States has not been a party to any disputes concerning these complex questions. However, it has actively intervened as a third participant, broadly expressing the view of the industrial countries participating in the OECD Arrangement. The viewpoint of the United States can be summarised as follows:

1) In contrast with Brazil's viewpoint, item (k) refers exclusively to export credits and not to export subsidies in general.[59]

2) The term "interest rate provisions" in item (k) encompasses all the terms and conditions of the OECD Arrangement.[60]

3) The matching of supported rates in accordance with Art. 29 of the Arrangement falls within the scope of the item, even though the matched conditions are not consistent with CIRRs.[61]

4) Finally, in the US view, the Illustrative List, in addition to listing practices that constitute prohibited export subsidies, also lists certain practices that do not constitute prohibited export subsidies, and, therefore, no further proof of the

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[57] Brazil-Export Financing Programme for Aircraft – Report of the Panel (14/4/1999). WT/DS/46/R, para. 7.2
[58] WT/DS/46/R, para. 7.2
[59] See in particular WT/DS46/R, para.5.18
[60] Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU. Report of the Panel (26.7.2001). WT/DS46/RW/2,annex c-3 paras 22.-23.
[61] Ibid, paras 22-23.

absence of contingency on export is required. The United States has pointed out that, where an item of the Illustrative List does address a particular type of practice, that item sets forth the standard for determining whether that practice is, or is not, a prohibited export subsidy. In particular, according to the US, when item (k) provides that export credits constitute prohibited export subsidies "in so far as they are used to secure a material advantage in the field of export credit terms", the mentioned item, by necessary implication, also provides, "a contrario" that export credits do not constitute prohibited export subsidies if they are not "used to secure a material advantage in the field of export credit terms". In short, not only should those credit terms that are covered by the "interest rate" provisions of the OECD Agreement be excluded from the prohibited category, but also other credit practices, such as matching, as long as they do not secure "material advantage".[62]

The panel disagreed with Brazil's suggestion that a consideration whether an item (k) payment is used to secure a material advantage in the field of export credit terms involves a comparison between the export credit terms of the transaction supported by the payment and the export credit terms of potentially competing transactions, arguing that a material advantage occurs when government payment "is used to secure export credit terms that are materially more favourable than the terms that would have been available in the absence of the payment". [63]

The Appellate Body reversed the Panel's reasoning, even though it finally upheld its findings, pointing out that its interpretation of "material advantage" in

[62] WT/DS46/AB/R, para.90.
[63] Brazil-Export Financing Programme for Aircraft – Report of the Panel (14/4/1999). WT/DS/46/R, para. 7.23

item (k) boils down to "benefit", thus making the "material advantage" clause superfluous in relation to Art. 1.1(b) of the Agreement.[64]

On the other hand, the Appellate Body did not provide a definition of what constitutes "material advantage", but just noted that the second paragraph of item (k), which refers to the OECD Arrangement, is a "useful context for interpreting the "material advantage" clause in the paragraph", arguing, therefore, that the "Arrangement" can "provide a specific market benchmark by which to assess whether payment by governments ...are used to secure a material advantage in the field of export credit terms". From this the Appellate Body inferred that the ascertainment of whether a government payment is used to secure a "material advantage" as opposed to an "advantage that is not material" may depend on whether the actual interest rate applicable in a particular export sale transaction after deduction of the government subsidy (the net interest rate) is lower than the so-called "commercial interest reference rate (CIRR)", which under the OECD Arrangement is the minimum commercial rate available, according to the length of maturity, for a particular currency.[65]. Finally, the Appellate Body denied the possibility that the Brazilian practice could be considered an instance of "matching" under the OECD Arrangement as the latter does not allow "a comparison between the net interest rate applied as the consequence of subsidies granted by a particular member and the total amount of subsidies provided by another member", as in the case under review, but concerns just the equalisation of the terms of an export credit.[66]

It must be noted, however, that from the statement of the Appellate Body it appears that the CIRR benchmark is just a first sight indication for the occurrence

[64] Brazil – Export Financing Programme for Aircraft – Report of the Appellate Body (20/8/1999). WT/DS46/AB/R, para. 179.
[65] Ibid., paras. 181-82.
[66] Ibid., para.185.

of "material advantage". Actually, the Appellate Body, in a subsequent Art. 21.5 case, concerning the implementation of the DSB recommendations and rulings on Brazil-Aircraft", explained that the CIRR is "one example of a market benchmark that may be used to determine whether a payment is used to secure a material advantage" and that "where the CIRR does not, in fact, reflect the rates available in the marketplace, "a Member should be able, in principle, to rely on evidence from the marketplace itself in order to establish an alternative "market benchmark", on which it might rely in one or more transactions".[67] [68]

The US outlook is only partially reflected in the WTO case law. Certainly, as illustrated by the above-outlined dispute, the panels and the Appellate Body have accepted that item (k) refers only to export credits, and that it should not be read in isolation. On the other hand, the US suggestion that the entire body of the Arrangement should be taken into account for SCM purposes has not been favourably considered.

With regard to the first paragraph of item (k) – containing the "material advantage" clause - in a further Art. 21.5 case concerning "Brazil-Aircraft" the panel, stated, in line with the first panel report on the controversy in question, that only those measures explicitly referred to in the Illustrative List as not constituting export subsidy should not be prohibited under any provision of the Agreement, and, therefore, the absence of "material advantage" is not enough to definitely exclude the possibility of conflict between an export credit measure and the SCM Agreement provisions.[69]

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[67] Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU. Report of the Appellate Body (21.7.2000). WT/DS46/RW/2., para. 64.

[68] Article 21.5 of the U.R. Dispute Settlement Understanding provides that "where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendation and rulings, such disputes shall be decided through recourse to these dispute settlement procedures, including wherever possible, resort to the original panel"

[69] Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU. Report of the Panel (26.7.2001). WT/DS46/RW/2, para. 5.274

With regard to the second paragraph of item (k) – which provides for a safe harbour from the general ban on export subsidies to those export credits that conform to the interest rate provisions of the OECD Arrangement - both the "Canada-Aircraft" and the "Brazil-Aircraft" Art. 21.5 panels have argued that the interest rate provisions of the OECD Arrangement include not only those articles that directly or explicitly pertain to interest rates as such, i.e., those on minimum interest rates, as well as those on the construction of CIRRs and their application, but also those provisions that support or reinforce the former articles; in particular the provisions on minimum cash payments, on maximum repayment terms, or on maximum validity periods for export credits. The Art.21.5 panels justified this broader interpretation pointing out that any financial transaction consists of a package of financing terms and conditions, many of which affect the interest rate. For instance, an interest rate in line with the CIRR would result in a much lower rate if joined with an abnormally long grace period for principal repayment, or with low down payments. However, the panels have pointed out that not all substantive provisions of the Arrangement, by the mere fact that they affect the minimum interest rate, "ipso facto become an interest rate provision". Therefore, all the provisions of the OECD Arrangement that do not support the minimum interest rate provision are outside the scope of the second paragraph of item (k) and, thus, can constitute a prohibited export subsidy.[70] Particularly with regard to matching, the Art. 21.5 panels distinguished between matched "permitted exceptions" and "matched derogations", arguing that only the former, which comply with the "minimum interest rate" provision and the supporting provisions of the Agreement, are covered by item (k).[71]

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[70] WT/DS46/RW/2, paras. 5.103-5.106.
Canada- Measures Affecting the Export of Civilian Aircraft. Recourse by Brazil to Article 21.5 of the DSU. Report of the Panel (9.5.2000). WT/DS70/RW, paras5.111-5.117.
[71] WT/DS70/RW, paras. 5.124-5.126.

The Art. 21.5 reports have been criticised not only by the United States but also by other industrial countries which participate in the OECD Arrangement. Indeed, the "Canada -Aircraft" reports do not seem free from flaws. In particular, the interpretation of item (k) seems to result in a partition between the SCM Agreement and the OECD Arrangement, in contrast with the rationale for the inclusion of item (k) in the Export Subsidy List which aimed at recognising the efforts of the Arrangement to regulate competition among the major export credit providers, and at the same time create a more level playing field, by allowing a safe harbour to export credits complying with the OECD provisions.

### *6) Actionable subsidies*

Art. 5 of the SCM Agreement places a third category between prohibited and non-actionable subsidies: actionable, or yellow light subsidies. Actionable subsidies are often viewed as a default category, consisting of subsidies other than those prohibited and non-actionable.[72] Actually, there are specific requirements for a subsidy to belong to this category. Basically, the subsidy must be, 1) specific and 2) injurious to the domestic industry of another WTO member, or must cause nullific ation or impairment of benefits accruing to it, or serious prejudice to its interests. The main difference with article 3, therefore, seems to lie in the fact that whereas prohibition results from the goal of subsidisation, i.e., from its link with trade distorting objectives, actionability comes from the "adverse effect" of the subsidy.

The first form of adverse effect, injury to the domestic industry of another WTO member, is defined in the same way as for countervailing measures. and,

WT/DS46/RW/2, paras. 5.113-5.116.

[72] See Mitsuo Matsushita, Thomas J. Schoembaum and Petros Mavroidis, *The World Trade Organisation. Law Practice and Policy* (Oxford:Oxford University Press, 2003) p.279.

therefore, must be based upon the objective examination of the impact of subsidised imports on prices in the domestic market for like products and on the domestic producers' performance. [73]

The term "nullification and impairment" is used in the same sense as in the relevant provisions of GATT 1994.[74] Adverse effect could, in particular, occur in keeping with GATT Art, XXIII:1(b) non-violation cases, where the following conditions are realised: 1) a concession has been negotiated resulting in tariff binding: and 2) the introduction into the territory of the country that has bound its tariff of a subsidy scheme which impairs the benefit of the concession for the addressee country of the promise of binding.

According to SCMA Art.6.3, the third hypothesis, serious prejudice, can arise when:

1) the effect of the subsidy is to displace or impede imports of like products into the subsidising member's market, or exports of like products to a third-country market;

2) the subsidy causes significant price undercutting or significant price suppression of a like product;

3) in the case of primary products, the subsidy increases the world market share of the subsidising country over its previous three-year average.

Art. 6.1 created a rebuttable presumption of serious prejudice for so-called dark amber cases if the total subsidisation amounts to more than 5 percent of the product value, if subsidies are extended to cover the operating losses of an industry or of an enterprise, or if they are provided in the form of debt forgiveness or debt repayment. Paragraph 1 of Annex IV provided that total ad valorem subsidisation must be calculated with reference to the cost to the government.

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[73] Art.5, footnote 11.

[74] Art. 5, footnote 12.

However, dark amber cases are no longer applicable as, under Art. 31 (Final provisions), they only apply for a period of five years from the date of entry into force of the WTO Agreement, i.e., the end of 1999, and the WTO members did not agree to extend their application.

As usual the WTO jurisprudence has shed light on some of the controversial aspects contained in Part IV of the SCMA. The "US- Upland Cotton" case, which probably is going to be the first volley in a series of attacks carried out by Latin American countries against the US farm policy along with the EU's CAP, concerned a set of agricultural programmes designed either to boost American exports or to protect farmers' incomes in the domestic market. As regards domestic subsidies, the panel and the Appellate body considered their ability to cause serious prejudice, focusing on three specific topics - 1) the relationship between the effects of a subsidy and the constituent blocks of the subsidy concept and, therefore, the autonomy of the actionable subsidy discipline under Part III of the SCMA from other titles of the Agreement; 2) the concept of market and its relevance with regard to the various subsections of SCMA Art. 6.3; and 3) the concept of world market share.

The subsidies under review were "captured" by the provisions of the SCMA – Part III, because, contrary to US opinion, they were considered related to the type of production undertaken, and as such they were not decoupled subsidies falling in the so-called "green box". Thus, they were not sheltered from challenge by virtue of paragraph 13 (a) of the Agreement on Agriculture.[75]

In keeping with its countervailing duty practice (examined in depth in Chapter VI), the United States contended that recurring subsidies provided in marketing years prior to the period under review cannot be considered to cause

[75] United States – Subsidies on Upland Cotton – Ab-2004-5-Report of the Appellate Body (3.3.2005) WT/D267/AB/R., paras. 341-342.

serious prejudice in that period. The US noted that non-recurring subsidies, such as those bestowed for capital investment can be allocated over a number of years, while recurring subsidies must be allocated to the year to which they relate, that is, the year for which the payment is made. In the United States' view, subsidies provided for a marketing year cease to exist when the benefit is used up for production in that year and the eventual effects of these subsidies (whether as price undercutting or a greater market share) cannot be the subject of claims in years other than the year in which the subsidy was expended.[76]

The Appellate Body, upholding the opinion of the panel, held that the effect of a subsidy under Arts. 5 and 6 of the SCM Agreement should not be confused with the benefit flowing from a financial contribution, which is a component part of the subsidy. The text of Art.6.3 does not suggest that the effect of a subsidy is limited to or continues only for a specified period of time, and it applies to a subsidy whether it is recurring or non-recurring. The AB also found support for its argument in Art. 6.4 of the SCM Agreement which requires that the displacement or impeding of export be demonstrated over a representative period of at least one year so as to demonstrate clear trends in changes in market shares.[77]

The Appellate Body addressed the meaning of the terms "market" and "same market" with reference to the specific case of price undercutting and depression in art. 6.3 ( c ) of the Agreement, but which is extendable to other cases of adverse effect. The United States, with a rather strained interpretation of the text of the article, argued that the relevant market under Art. 6.3 ( c ) must be a particular domestic market of a member and cannot be the world market because

[76] Ibid., para.45.
[77] Ibid., paras. 474-480.

otherwise the subsidised product and the like product would necessarily be in the same market and, therefore, the term "same" would be redundant. [78]

Rejecting the United States' argument, the Appellate Body affirmed the opinion of the panel, according to which market is a geographical area of demand for commodities or services, and the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices. In contrast with paragraphs ( a ), ( b) and ( d ) of art. 6.3, paragraph ( c ) does not qualify the market concerned, which, thus, can be a domestic market, a regional market, or the world market.[79] For the AB, therefore, the location of the market concerned is a question of fact and must be left to a case-by-case analysis.[80] The only qualification provided by paragraph ( c ) is that the market must be the same. The ascertainment of the identity of the market concerned, in the opinion of the Appellate Body, can, however, rely on the above quoted definition of a place where demand meets supply. Thus, two products can be deemed to be in the same market "if they are engaged in actual or potential competition, even if they are not necessarily sold at the same time and in the same place or country".[81]

In defining the concept of market share in Art. 6.3 (d) for "serious prejudice" purposes, the panel (in a part of the opinion which was not considered in the appeal) rejected both the interpretation of Brazil, for which the relevant share is the "export share" and the relevant world market is the "export market" and the viewpoint of the United States, according to which the world market encompasses consumption of the agricultural produce in question, including consumption by a country of its own production. Noting that Part III of the SCM Agreement not only includes those subsidies that, while not contingent upon

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[78] Ibid., para. 409.
[79] Ibid., paras 404-405.
[80] Ibid., para 410
[81] Ibid., para.413.

export performance within the meaning of Article 3.1 (a), may still incidentally facilitate or promote exportation but also embraces subsidies that promote production itself, whether or not increasing exportation, the panel argued that the phrase "world market share" should be read in a manner which takes into account both production and exports.[82] Consequently, it considered that "world market share" in the text of Article 6.3 (d) refers to the share of the world market supplied by the subsidizing Member.[83]

On the other hand, the panel held that the US perspective which also took into account the increase in consumption of the member granting the subsidy to determine the expansion of its share in the world market would run counter to the underlying purpose of the subsidy disciplines in the Agreement. Indeed, as the panel pointed out, increased consumption would lead to enhanced demand which, if satisfied from imports, is likely to benefit, rather than adversely affect, the interests of other WTO members.[84]

A WTO panel also shed light on the concept of "same product" in footnote 46 to Art. 15 in a case in which the US was one of the complainants. The analysis was provided with regard to a set of measures established by the Indonesian government to support production and marketing of a low cost car produced in the Republic, some of which took the form of tariff and tax reductions and exemption. The European Communities and the United States claimed that such measures constituted subsidies, either prohibited under Art. 3.1 as import substitution subsidies or actionable as allegedly causing serious prejudice to foreign competitors producing like products. The panel interpreted the term "like product" narrowly, noting that according to footnote 46, it is not enough that the

[82] United States – Subsidies on Upland Cotton –Report of the Panel (8.9.2004) WT/D267/R., paras. 7.1447-1449.
[83] Ibid., para. 7.1450.
[84] Ibid. paras 7.1451-1453.

compared products have similar characteristics. Rather, they must closely resemble each other.[85] Thus, the fact that they belong to the same genus (in this case, cars) does not permit the inference that they are "like products" for serious prejudice purposes. Physical similarity is relevant, but cannot be viewed as an exclusive factor.[86] On the other hand, the panel suggested that price might be a relevant consideration, particularly where differences in price represent one way to assess the relative importance of differing physical characteristics to consumers. It noted, however, that excessive reliance on price differential could erroneously preclude an assessment of serious prejudice, in particular when it takes the form of price undercutting. Indeed, if the low price of the allegedly subsidised goods were to render them "unlike" competing products which are similar in physical characteristics but are priced higher, the result would be that the price undercutting claims under Article 6 could never prevail.[87]

7) *Non-actionable subsidies*

Art. 8 of the SCM Agreement made non-actionable three kinds of specific subsidies, the so-called "green light" cases:

1) subsidies granted to cover a portion of costs of research (up to a maximum of 75 percent of the costs) and pre-competitive development (up to a maximum of 50 percent).

2) subsidies bestowed to assist disadvantaged regions, provided that the assistance is given as part of a general scheme of regional development, the assisted region is a clearly designated, contiguous geographical area with a definable economic

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[85] Indonesia-Certain Measures Affecting the Automobile Industry – Report of the Panel (2.7.1988). WT/DS 54/R., paras. 14.172.
Ibid., para. 14.175.
[86] Ibid.para.14.173
[87] Ibid. para.14.192.

and administrative identity, and the assessment of disadvantage is based upon neutral and objective criteria.

3) subsidies provided to adapt existing facilities to new environmental requirements, if the facilities have been operational for at least 2 years, the subsidy is a non- recurring measure and does not exceed 20 percent of total costs.

While prohibited and actionable subsidies can be challenged under the WTO dispute settlement mechanism or subject to domestic countervailing duties, the above listed subsidies, if duly notified, were immune from action under both remedies. If they had not been notified they were to be treated as non-actionable if found to conform to the standards set forth in the Agreement.[88] On the other hand, for non-actionable subsidies, which nonetheless result in serious adverse effect to the domestic industry of a WTO member, a mutually acceptable solution should be sought, first by consultation and then by referring the question to the Committee on Subsidies.[89]

Article 8 also provides that non-specific subsidies are non-actionable, but this may be considered as the result of the more general rule providing for specificity in Art. 2 of the Agreement.

However, the time limit of the year 2000 under Art. 31, along with the end of the dark amber category supported by the US, meant the dismissal of the green light safe harbour, particularly dear to the European Communities. Already in 1996, Anderson and Husisisan cast doubts on the US Congress' willingness to extend the US green light provisions of the U.R. Agreements Act after July 1st, 2000. Indeed, though the Clinton Administration looked favourably at least at one green light item - research & development, Congress, whose majority was

88 Art.10, note 35.
89 Ibid.

Republican, went on formally opposing subsidisation, whether domestic or foreign.[90]

*8) Multilateral remedies and proceedings*

Like the Tokyo Round Code, the SCM Agreement provides two kinds of remedies: WTO dispute settlement proceedings, i.e., consultation and dispute panel proceedings; and countervailing duty proceedings. In contrast with antidumping, which does not permit a complaint until a domestic measure is taken, WTO dispute resolutions on subsidies can serve as an alternative to CVD proceedings. Under footnote 36 to SCM Art. 10, the provisions of parts II and III (concerning "red light" and "yellow light" subsidies) may be invoked in parallel with the provisions of part V (concerning countervailing measures). However, as far as the effects of a subsidy in the domestic market of the importing member are concerned, only one form of relief will be available, that is, either a countervailing duty or a measure decided by the Dispute Settlement Body (DSB) [91]

In dispute settlement proceedings a panel may provide relief in the form of a recommendation that the subsidy be withdrawn or that its adverse effect be eliminated, depending on whether a subsidy is "prohibited" or simply "actionable".

In the first case, SCM article 7 provides a more expedite timetable than that provided by the Dispute Settlement Understanding (DSU). Consultations must be entered "as quickly as possible" upon the request of a member who has reason to believe that a prohibited subsidy has been granted or maintained by another member. In the absence of an agreed solution within 30 days, either of the

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[90] M.Jean Anderson and Gregory Husisian, "The Subsidies", op.cit., p. 571
For a critical viewpoint on the "green light" subsidies regime see in particular William K. Wilcox, Gatt-Based Protectionism and the Definition of a Subsidy", B.U.Int'L.J. 16(1998) p. 161.
[91] See James R. Cannon. Jr., "Dispute Settlement", op.cit., p. 388.

two members may refer the matter to the Dispute Settlement Body (DSB) which must immediately establish a panel, unless there is an opposite consensus. The Panel must circulate its final report within 90 days and, if the report is not appealed, the DSB must adopt it within 30 days. If the panel report is appealed, the Appellate Body must normally issue its report within 30 days. Secondly, SCM Art. 4 provides for a more effective remedy than the usual WTO remedy, as, while DSU Art. 19 only provides that the losing party must bring its measures under compliance, SCM Art. 4.7 prescribes the withdrawal of the illicit subsidy.

In controversies on "yellow light" subsidies the procedure is less expedite and remedies are less stringent. Under article 7 of the SCM Agreement, if consultations between the parties concerned do not result within 60 days in a mutually acceptable solution, the complaining party may request the DSB to establish a panel, which has 120 days to submit its report. The DSB has 30 days to adopt the report, unless members decide by consensus not to adopt it, or one of the parties appeals. In the latter case the Appellate Body must issue its report within 60 days. Under Art. 7.8 members are required either to withdraw the subsidy or remove its effects.

In both "red light" and "yellow light" subsidy cases if the subsidising member does not take appropriate steps to withdraw the subsidy or remove its effect the affected member can take countermeasures after authority has been granted by the DSB.

***9)Countervailing duty proceedings***

Part V of the SCM Agreement largely reproduces the previous discipline set forth by the Subsidies Code. According to Art. 15 subsidies, whether prohibited or simply actionable, can be subject to countervailing measures only if there is material injury or threat of material injury to domestic industries. Material injury also includes the threat of material injury, and the material retardation of the establishment of an industry. Domestic industry, as a general rule, includes domestic producers of like products or a major proportion of such producers. It can also be limited to a regional market, if there is a concentration of imports into that market causing injury to local producers. A note to article 15 provides that the term "like product" shall be interpreted as a product which is alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.

The Agreement explicitly incorporates the US philosophy and methodology we examined in the preceding chapter as a minimum common denominator to assess benefit for countervailing duty purposes. Indeed, the heading of SCM article 14 is "calculation of the amount of subsidy in terms of the benefit to the recipient". In particular, the article provides that: 1) equity infusion by the government will not be considered a benefit if it corresponds to a private investor's criteria; 2) in loans and loan guarantees by governments only the difference between commercial and governmental paid loans and guarantees qualifies as benefit; 3) with respect to the provision of goods and services or their purchase, the benefit is the difference between the prevailing market conditions (in the country of provision or purchase) and the price paid to government.

The Agreement, however, requires the investigating authorities to examine all known factors that injure the domestic industry other than subsidised imports and not to attribute injury caused by them to the latter.

Investigations must be terminated if the amount of the subsidies is "de minimis", or if the volume of subsidised export is negligible. In the case of imports from industrialised countries subsidies are "de minimis" if less than 1 percent ad valorem, whereas for developing countries, subsidies of 2 percent ad valorem are considered "de minimis".[92] The volume of imports from developing countries is "negligible" if it is less than 4 percent of the total of imports of the like product into the importing country, unless the total amount of "negligible subsidies" exceeds 9 percent of the total imports of the like product.[93]

Following the US model the SCM Agreement permits an investigating authority to cumulatively assess the aggregate effects of imports from more than one country, if the subsidy from each country is more than "de minimis", if the volume of imports from each country is not negligible, and if the imports compete with each other.

Going beyond US practice, Art. 21 of the Agreement created a sunset clause by which a duty shall remain in force only as long as necessary to counteract the injurious subsidisation. Duties shall be terminated within five years, unless the investigating authority determines that the expiry of the duty is likely to lead to a continuation or recurrence of subsidisation and injury.

At any rate, the SCM Agreement does not challenge the US statute and practice according to which countervailing duties are imposed to the full amount of the estimated subsidy. Indeed, the first sentence of Art. 19.2 leaves to WTO members the choice between imposing duties matching, but not exceeding, the level of the subsidy and imposing lower duties if adequate to remove the injury to the domestic industry. The second sentence of Art. 19.2 favours the second alternative, but clearly it is simply hortatory.

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92 Art.11.9.
93 Art.27.10.

**Conclusion**

Two American scholars, concluding a review of the WTO Antidumping and Subsides Agreements in the first five years since their entry into force, give a doubtful response to the question of whether the United States achieved its objectives in the Uruguay Round. In particular, they find factors of concern in the limited deference accorded by WTO panel reports to US decisions in countervailing duty inquiries and in the uncertain effectiveness of the new subsidy regime in securing the curtailment of subsidisation practices.[94] The foregoing sections bears out by and large their judgement, although not exactly for the same reasons.

Certainly, the United States was able to impose its perspective in key sectors of the reformed subsidy and countervailing measures regime.

Firstly, the definition of subsidy adopted the concept of benefit to the recipient rather than that of cost to government put forward by the European Communities along with other industrialised as well as developing countries. Besides, although the SCM Agreement does not provide a definition of benefit, WTO decisions have made it clear that the main yardstick to assess existence and amount of benefit is the market, in keeping with US legislation and administrative practice. And the US achievement with regard to Art. 1 is strengthened by the choice by Art. 14 of the relevant section of the Agreement of the US market-oriented practice as the minimum common denominator to assess the legitimacy of countervailing duty measures.

Secondly, the US has secured the extension of the prohibited subsidies regime to those practices that do not foster imports but raise barriers to foreign

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[94] Paul C. Rosenthal and Robert T.C. Vermylen, "the WTO Antidumping" op.cit., p. 894.

goods imports, which was a recurrent preoccupation for the United States during the 1980s.

Thirdly, as already noted with reference to SCM Art. 14, the countervailing proceeding discipline largely reproduces US legislation and administrative practice in the period that followed the Tokyo Round Agreements, the concept of cumulation being just one of the prominent examples. Certainly, thresholds and terms of reference provided by the SCM Agreement can offer better treatment to the exporter than the previous US practice, but in so doing they give recognition to such practices.

The success is not complete, though.

The DSB has rejected the US attempt to enlarge the financial contribution concept so as to encompass economic policy measures that depress the cost of inputs used in the production of goods for export, thus affording competitive advantage to exporters. As regards export subsidies, the WTO decisions run counter to the US broad interpretation of subsidies contingent upon export performance, requiring, instead, a relation of strict conditionality between subsidisation and exports. The United States has not secured full recognition of the role of the OECD Arrangement in regulating all aspects, that is, not only interest rates, of export credit subsidisation.

If the United States has been able to definitely attract domestic subsidies into the WTO regime, it has failed to secure a particularly stringent discipline for some of them. Subsidies like debt forgiveness or those destined to cover operating losses of industries and firms are not considered prohibited subsidies nor are they included anymore in a dark amber category, as art. 6.1 of the Agreement expired in 1999. The interpretation by the United States of certain key concepts of serious prejudice has been rejected in a recent case concerning US farm policy.[95] It seems, however, that the US perspective in such a case was more tactical than strategic, as it aimed to defend some relevant measures of US farm policy rather than to assert a general viewpoint on the application of multilateral remedies with regard to actionable subsidies.

Finally, the United States did not try to reopen the issue of equivalence of the various fiscal export regimes from the subsidisation angle during the Uruguay Round. Indeed, the rather vague wording used to address fiscal treatment as a form of financial contribution under art. 1 of the Agreement soon turned out to be a sword of Damocles on the US fiscal incentives to foster its exports.

[95] See supra, United States – Subsidies on Upland Cotton –Report of the Panel (8.9.2004) WT/D267/R. United States – Subsidies on Upland Cotton – Ab-2004-5-Report of the Appellate Body (3.3.2005) WT/D267/AB/R

## CHAPTER V

## THE IMPACT OF THE MULTILATERAL REGIME ON THE US LEGISLATION AND THE TAX ISSUE. THE US IN THE DOCK AS SUBSIDISER IN THE FSC-ETI CASES

### Introduction

In the previous chapters we have prevalently focused on the impact that concepts, methods and approaches developed in the United States had on the establishment of the multilateral regime on subsidies and countervailing duties. In this last part we concentrate on the influence that the latter has on the evolution of the US regime. We examine this process from two angles, in accordance with the approach of the WTO itself; in the WTO dispute website we find a heading for countervailing measures, while the other disputes concerning alleged subsidisation are placed separately. In the following chapters we shall focus on the US CTV regime. In this chapter we look at one case of alleged subsidisation, actually divided into two stages: the Foreign Sales Corporations dispute and its continuation under art. 21.5 of the DSU, the ETI dispute.

The FSC dispute originates from the US attempt, already examined in chapter II, to create a level playing field between its tax regime, prevalently relying on income tax, and that of its European trading partners based on consumption taxes, and in particular the Value Added Tax (VAT), whose deduction from exported goods is allowed by the GATT. Because of its roots the FSC dispute is rather different from other subsidy cases and such distinctiveness makes it one of the landmarks in the recent history of WTO controversies, together with the banana and hormones disputes. In other subsidisation cases we are confronted with measures which are often rather complex but can be analysed on the basis of the SCM Agreement and of GATT 1994. The only thing the interpreter has to do is to examine the measure in the light of the above-mentioned rules. The FSC – ETI measures are, instead, an integral part of the US taxation system. At least, the US grounded its defence on this notion. We cannot take as granted that the measures in question merely allow the foregoing of revenue that is "otherwise due" under US law. Rather, the question is firstly whether the FSC measure and its replacement are a separate tax scheme or are just a piece in the complex US fiscal fabric. In other words, is the FSC-ETI regime a waiver from what is "otherwise due", or is it an autonomous set of rules, that is, the "otherwise due" itself ?

To have an in-depth view on this subject we cannot, therefore, leave aside the place and role of the FSC scheme and that of the ETI measure within the US tax regime. Based on this premise this chapter is divided into six sections. In the first section we examine the FSC measure trying to look at it with reference to other relevant US tax rules. Then we examine the DSB reports both with regard to the interpretation of the SCM Agreement and to the analysis of the FSC scheme. In the following two sections we repeat the exercise with regard to the ETI Act. Finally, we examine the last developments of the controversy until the second DSU Art. 21.5 panel report of September 2005 and review some of the proposals put forward by American scholars to find a satisfactory way-out. As regards the reports of the panel and of the Appellate Body the examination refers only to the SCM Agreement, leaving aside those aspects concerning the Agreement on Agriculture.

## 1) The subject of contention: Foreign Sales Corporations (FSCs)

*The FSC in the context of the US tax regime*

As noted in chapter III, the 1981 Council Decision which adopted the panel reports on the tax disputes between the US and some EEC member states qualified the reports in three ways:

1) by providing that a country is not required to tax economic processes located outside its territory;

2) by stating that it may utilise measures to avoid double taxation of foreign source income;

3) by providing for the application of the arm's length pricing principle between exporting companies and foreign traders. However, it cannot be viewed as an absolution for the DISC programme, as this measure was nothing but a tax deferral of income accruing from economic processes carried out in the US.

Correctly, perhaps, in that particular phase of GATT history, the US interpreted the decision as allowing the Parties concerned not to tax some activities carried out outside their borders, without having to leave out the whole of the activities located outside their fiscal boundaries. In other words, in the opinion of the United States, the Decision did not prescribe an alternative between a fully-fledged exemption system and a tax credit system, but it allowed the co-existence of both regimes. To understand this approach we must provide an outline of the US tax regime, though certainly not a comprehensive one.

Most American scholars who have written about the DISC-FSC- ETI saga, point out that US taxpayers – either citizens or residents or companies incorporated in the United States – are taxed on their worldwide income. Thus, as regards domestic corporations, that is, those organised under the law of one of the states or the District of Columbia, no distinction is made between income from sources inside or outside the United States, except that taxes on foreign income may be reduced by foreign tax credit.[1] Much less straightforward, however, is the US fiscal treatment of foreign companies and of their relationship with their United States parent companies. According to section 881 of the Internal Revenue

[1] In particular, IRC section 61 provides that "gross income means all income from whatever source derived".

Code (IRC), a foreign corporation is taxed on fixed or determinable periodical income accrued in the US, such as interests, dividends and royalties, at a flat percent rate on gross income. Also, under IRC section 882, if a foreign corporations is engaged in trade or business in the United States, the net income that is effectively connected with the conduct of that trade or business will be taxed in the same manner as the income of a US company. Generally, in the case of business income, only income from US sources will be effectively connected income and, therefore, subject to taxation in the same way as the income of a US taxpayer. Foreign source income is treated as effectively connected income if it is attributable to a place of business in the United States. In the latter case, however, there can be the problem of allocating the income between the country of production and the country of sale, that is, the US. In most cases the allocation is determined according to regulations worked out by the US tax authority.[2] Generally, foreign income non-connected to trade or business in the United States, or not accruing from US sources, is only taxable if it is repatriated as dividend.

From the foregoing it follows that under the system applying to US companies, if the corporation conducts business abroad through a branch, the income so produced is part of its tax base. Instead, if the business were carried out through a foreign corporation, there would normally be no US taxation until and unless the earnings of the foreign corporation were distributed to American shareholders. That would allow the latter to defer the moment of taxation on their foreign activities playing on the deferral of dividend distribution made possible by the fact that foreign subsidiaries are considered separate persons; and thanks to the

[2] To give a relevant example with respect to the FSC case, income from the sale of property manufactured abroad and sold in the United States by a US office of the foreign company is allocated under the relevant regulation by applying, in the first place, the sale price to an independent distributor (i.e., the arm's length principle). If such a price cannot be ascertained, then one half of the taxable income is allocated on the basis of a comparison of the sales value within the US and in the foreign country. Either in the case of the application of the arm's length principle or in the case of the sale ratio rule, the basic point is the presence of a permanent establishment of the foreign company in the US.

accrual of compound interests tax deferred for many years can almost be the same as tax forgiven.

In 1962, however, when capital account problems, rather than trade balance problems, were beginning to make themselves felt, Congress enacted Subpart F of the Internal Revenue Code (IRC) piercing the fiscal veil between US taxpayers and their foreign subsidiaries.[3] Where a foreign corporation is controlled for an uninterrupted period of 30 or more days by US shareholders, whether individuals or companies, such shareholders are taxed for their quota of the corporation's undistributed earnings as well as on its distributed earnings (IRC sections 951 and 958). It must be noted, however, that Subpart F provides for a specific, rather high, holding and does not necessarily apply to the whole of the income accrued to the subsidiary. In particular, with regard to "foreign base company sales income" - which is the hypothesis that has more points in common with the FSC rules, as it concerns property purchase from, or sold to a related party – under IRC section 954, the income accrued to the foreign affiliate is attributed to its US shareholders, only if the foreign company is deemed to be used as an intermediary to channel income produced by a related party towards countries with a more favourable tax regime. On the other hand, income considered to be generated by genuine activity carried out by the affiliate is not directly taxable to US shareholders.[4] The purpose of the provision, therefore, is to

[3] See, in particular, Paul McDaniel and Hugh .S.Ault, *Introduction to United States International Taxation* (New York: Kluwer Law and Taxation Publisher, 1989)p. 118 et seq.
Also Eric T.Laity,"Defining Foreign Base Company Income: The Exclusions, Deductions and Limitations", *Berkley J. Int'l L.* 19(2001) p. 94.

[4] See in particular, Brian J. Arnold, "The Taxation of Controlled Foreign Corporations: Defining and Designating Tax Havens", *B.T.R.*, 1985, p. 2929 et seq.
Also Boris J. Bittker, Laurence Stone, William Klein, *Federal Income Taxation* (Boston: Little Brown Company, 1984), p. 112 et seq.. Paul McDaniel and Hugh .S.Ault, *Introduction*, op.cit, p. 175 et seq..

deal both with deferral of US taxes and avoidance of taxes imposed by high-rate foreign countries.[5]

If Subpart F was advantageous for the US Executive from the income revenue perspective, from the subsidy rules angle, in the words of Hufbauer, it was "a self- inflicted injury".[6] Indeed, given the unavailability of rebates for income tax under GATT art. VI, the greater the scope of the US tax power, the greater the gap with the advantages made available to exporters from the other side of the Atlantic, in particular because of the VAT mechanism allowing them to deduct the tax paid in previous stages of production without having to bear further fiscal burdens at the export stage.[7] It must be noted, however, that many scholars at both sides of the Atlantic have seen the root of the Western European fiscal competitive edge in the direct tax regime of many European States, whether members of the EC or not, which, in their opinion, in contrast to the US approach, only assesses income generated territorially.[8] The first attempt to fill the gap was

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[5] Apart from "foreign personal holding company income", under section 954(a), which mainly consists of passive income, such as interest, dividends, rents and royalties and the net gains from the sale of assets producing these income flows, the main category of foreign base company income is that of "foreign base company sales income", under section 954 (d). This category includes income from property purchased from, or sold to, a related party – which needs not be a US corporation – if the property is manufactured and sold for use outside the country of incorporation of the foreign company controlled by US shareholders. On the other hand, if the goods sold by the controlled company are intended for use inside the country of its incorporation, the income is not considered as "foreign base company sales income". Likewise, if the controlled foreign company manufactures the product sold, the income is not considered as "foreign base company sales income" and, therefore, is not directly taxable to the shareholders according to subpart F. Analogous rules apply under section 954(e) to "foreign base company service income", that is, income deriving from services performed by controlled foreign companies. Thus Subpart F applies to services performed by or on behalf of a related person, outside the country of incorporation of the controlled company. If these services are performed within the country of incorporation or are directly related to the sale of goods manufactured by the company, the income is not directly taxable to the US shareholders.

[6] Gary Clyde Hufbauer, "The Foreign Sales Corporation Drama: Reaching the Last Act?", *Int'l Econ.Pol'y Brief*, n. PB02-10 (2002), p 3.

[7] See Chapter II, section 1.

[8] See for instance, Hale E. Sheppard, "Rethinking Tax-Based Export Incentives: Converting Repeated Defeats Before the WTO into Positive Tax Policy", *Tex. Int'l L.J.*, 39(2003) p.122. Cecelia BB. Skeen, "Knick-Knack Paddy Whack Leave the FSC Alone: An Analysis of the WTO Panel Ruling That the U.S. Foreign Sales Corporations Program is an Illegal Export Subsidy Under the GATT", *New Eng.L. Rev.*, 35 (2000-01). p 97.
Also, Asif H. Qureshi and Roman Grynberg, "United States Tax Subsidies Under Domestic International Sales Corporation, Foreign Sales Corporation and Extraterritorial Income Exclusion

the Domestic International Sales Corporation (DISC) legislation, but the United States had to accept the fact that the DISC scheme was not consistent with the GATT provisions.

The solution to this long-lasting problem, in the US view, lay in applying the principle embodied in the 1981 Understanding in a selective way, exploiting the room for manoeuvre provided by the complex web of tax rules and administrative regulations concerning foreign income. In keeping with the US interpretation of the 1981 Decision, the key to overcome this handicap was a well qualified exemption of income from sources outside the United States.[9] In line with the main features of the US tax system, a fundamental requirement was the establishment of "ad hoc" foreign corporations, as US companies remained subject to the worldwide tax basis principle of taxation.

*Features of the FSC programme*

As part of the Deficit Reduction Act of 1984 (P.L. 98-369), Congress enacted the Foreign Sales Corporations (FSCs) programme to provide an export tax incentive "comparable to DISC in terms of benefit to exporters and cost to Treasury", while eliminating the controversy over the DISC regime.[10] This time the instrument for tax benefit provisions was no longer a domestic corporation but a company established outside the US fiscal borders, usually a shell subsidiary. Yet, according to US legislation, the FSC was a separate fiscal entity whose

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Act Legislation within the Framework of the World Trade Organization", *J.W.T.*, 36 (2002) n.5, p. 980.

[9] Section 801 of the Deficit Reduction Act of 1984 provided that "Part III of Subchapter N of Chapter I (referring to income from sources outside the United States) is amended by inserting after subpart B the following new chapter: ...".

[10] Ronald D. Sernau,"The Foreign Sales Corporation Legislation: A $ 10 million Boondoggle " *Cornell L. Rev.*71 (1986) p.1190.
Also Nicholas J. Minella "Note and Comment: Motives and Consequences of the FSC Dispute: Recent Salvo in a Long Standing Trade War or Fashioning a Bargaining Chip?" *Brooklyn J. Int'l L.* 27 (2002), p. 1081.

recognition was conditional under strict requirements.[11] Under I.R.C. sect 922 (a) the FSC was a foreign corporation organised under the law of a qualified foreign country, or certain US possessions, like Guam or the Virgin Islands. A country was qualified if there was agreement for an exchange of information with the United States. The fact that the foreign country could, in turn, tax the FSC's earnings lessened the value of the incorporation of a foreign company. For that reason most US corporations organised their FSCs in countries with low or no income and dividend withholding taxes. The Virgin Islands were the preferred location.[12]

If a corporation qualified as FSC, a share of its "foreign trade income" was exempt from US corporate income tax, and that portion could be distributed as a tax- free dividend to the US parent company. Under IRC sect. 924(a) the income of a given FSC, from any transaction, was considered foreign trade income if three requirements were satisfied: the income was export-related, the management took place outside the US, and the economic process giving rise to foreign trade income took place outside the US.

1) The income was to be export-related so as to make sure that the tax benefit was conferred only upon export income and not income the FSC might get from other activities, such as investments. Foreign Trade Income was defined by sect. 923(b)

[11] John M. Gray, "Foreign Sales Corporations Replace Domestic International Sales Corporations" *HILJ* 26(1985) p. 302.

[12] Section 881 of the Internal Revenue Code states that for the purpose of determining whether foreign source income is connected or not connected with United States business, a corporation created or organised in Guam, American Samoa, the Northern Mariana islands and the Virgin Islands or under the law of any such possession shall not be treated as a foreign corporation if the value of stocks beneficially owned (directly or indirectly) by foreign persons does not exceed a certain threshold.
According to Stehman the fact that FSCs were predominantly located in US possessions, casts doubts on the foreign character of the FSCs, which is the rationale for their tax exemptions. The scholar also points out that section 932 of the IRC provides that the United States will be treated as including the Virgin Islands for purposes of determining the US tax liability of US citizens or residents with Virgin Islands' income. Oliver Stehmann "Foreign Sales Corporations under the WTO. The Panel Ruling on US Export Subsidies", *J. W. T.*, 34 (2000) 6, p. 94

as "the gross income from foreign trade gross receipt", i.e., receipts attributable to the sale or leasing of export property outside the US, or services in connection with the sale or lease. Export property was defined by sect. 927(a) as property produced in the United States, no more than 50 percent of the fair amount of which was attributable to raw materials imported into the US.

2) IRC sect. 924 (b) provided that for the management of the FSC to take place outside the US, the meetings of the board of directors had to be held abroad, the principal bank account was to be maintained outside the US and all the dividends, compensations of officers and legal and accounting fees were to be paid from foreign bank accounts.

3) Pursuant to sect. 924(d), the foreign economic process requirement was satisfied if the FSC had participated outside the US in the solicitation, negotiation or the stipulation of a contract referring to an export transaction. This requirement, however, could be fulfilled if there was a contract between the foreign company and its US parent (or other US or foreign subsidiaries) pursuant to which all the export activities were performed by the related party. Secondly, a specified percentage of the transaction costs had to be borne by the FSC. The exempt portion of the FSC's foreign trade income was calculated on the basis of arm's length pricing between the foreign company and its related supplier or on the basis of administrative pricing rules designed to determine the foreign trade income allocated to the FSC.

According to sect. 921 (b), if arm's length pricing was used in a transaction, 31 percent of the foreign trade income was treated as exempt foreign trade income. The administrative pricing rules could take two forms. If, according to section 925 (a)(2), 23 percent of the combined taxable income realised by the FSC and its US parent company was allotted to the Foreign Sales Corporation then, pursuant to sections 924 (a)(3) and 921 (b), 16/23 of such income was treated as exempt foreign trade income. This means that 16% of the combined income of the US trade company and its foreign subsidiary was exempt from taxation. The alternative administrative pricing rule under section 925(a)(3) would give the Foreign Sales Corporation a profit of 1.83 percent of the foreign trade gross receipts realised by the FSC on its resale of the product. We provide below a comparison of the alternatives available to US taxpayers (Table 1). The benefit was not limited to the foreign corporation but directly extended to its US parent company. Pursuant to section 245 ( c ) of the IRC, the US corporation that received a dividend distribution out of earnings and profits of its foreign affiliate was entitled to a 100 percent dividend received reduction. As a result there was no US corporate tax on the exempt foreign trade income.

**FISCAL TREATMENT OF FOREIGN SALES CORPORATIONS**

| | |
|---|---|
| ***ASSUMPTIONS*** | |
| 1) FSC's foreign trading gross receipts | 1,000,000 |
| 2) FSC's direct expenses | 200,000 |
| 3) Parent corporation's costs of good sold | 450,000 |
| 4) Parent corporation's direct expenses | 150,000 |
| 5) Combined foreign trade income (1-2-3-4) | 200,000 |
| **A) Arm's length method** | |
| 6) Transfer price of goods sold by the parent company to its FSC assessed at arm's length value | 750,000 |
| 7) FSC's foreign trade income (1-6) | 250,000 |
| 8) Exempt foreign trade income (31% x 7) | 77,500 |
| 9) Allocable direct expenses of FSC (31% x 2) | 62,000 |
| 10) Profits not subject to US tax (8-9) | 15,000 |
| **B) Combined taxable income method** | |
| 11) Deemed FSC's profits (23% x 5) | 46,000 |
| 12) Derived administrative transfer price for sales by parent company to FSC (1-2-11) | 754,000 |
| 13) FSC's foreign trade income (1-12) | 246,000 |
| 14) Exempt foreign trade income (16/23 x 13) | 171,130 |
| 15) Allocable FSC's expenses (16/23 2) | 139,130 |
| 16) Profit not subject to US tax | 32,000 |

**FISCAL TREATMENT OF FOREIGN SALES CORPORATIONS**

**C) Foreign trading gross receipts method**

| | |
|---|---|
| 17) Deemed FSC's profits (1,83% x 1) | 18,300 |
| 18) Derived administrative transfer price for Sales by parent company to FSC (1-2-17) | 781,700 |
| 19) FSC's foreign trade income (1-18) | 218,300 |
| 20) Exempt foreign trade income (16/23 x 19) | 151,861 |
| 21) Allocable FSC's expenses (16/23 x 2) | 139,130 |
| 22) Profit not subject to US tax | 12,731 |

These fiscal savings made FSCs very popular with exporting American companies. More than 6,000 US corporations benefited from the FSC tax regime, including large multinationals like Boeing, General Electric and Motorola. Boeing alone saved 130 million US $ in 1998. Also small and medium enterprises benefit from the scheme, saving on average 124.000 US $ annually.[13]

**2) The rules of the game: the FSC provisions in the light of the SCM Agreement**

Even before the start of the Uruguay Round, the European Community expressed concern about some FSC provisions. In particular, the Community, by a rather extensive interpretation of the Understanding reached in 1981, claimed that since a Party to the General Agreement is not required by the Understanding to tax economic events that occur outside its territorial limits, it is implicitly obliged to tax economic processes taking place within its boundaries. Thus, by not imposing taxes on the latter income the US bestowed illegal export subsidies.[14] The Community also argued that the availability of administrative pricing methods runs counter to the arm's length principle in the assessment of transaction earnings between related parties. However, no complaint was lodged

[13] See James Joseph Shallue, "An Analysis of Foreign Sales Corporations and the European Four Billion-Dollars Retaliation", *Denv.J.Int'l L & Pol'y*,31(2002), p. 201.

[14] See Jeffrey F. Ryan, "An Analysis of the Gatt compatibility of the New Foreign Sales Corporations" *Santa Clara Law Review*, 26(1986) p. 707.

during the negotiations for a new multilateral regime on subsidies and countervailing measures in the Uruguay Round.

Many commentators have argued that the European Communities rekindled the controversy on the alleged US tax subsidy regime as it wanted to create a bargaining chip to reach a negotiating settlement on a series of disputes it had already lost, such as the beef hormone dispute, and to forestall US challenges against a variety of EU practices, such as trade barriers against GMO, and subsidies to the European champion Airbus.[15] It is also arguable, however, that the Communities believed that the time was ripe for bringing the controversy to the WTO because the SCM Agreement had profoundly curtailed the room for manoeuvre afforded by the 1981 Understanding.

In 1997, after mandated consultations had failed, the Communities filed a complaint challenging the US FSC programme. The Communities argued that the FSC programme granted two forms of subsidy that violated articles 1 and 3(1) of the SCM Agreement. Firstly the European Communities contended that the FSC provisions allowed exemptions to income tax otherwise due to both Foreign Sales Corporations and their US parent companies. Secondly, the Communities submitted that the administrative pricing rules in the United States FSC regime derogated from the normal transfer pricing rules and increased the income shielded from taxation.[16] Both hypotheses were prohibited subsidies pursuant to article 3(1)(a), being contingent on export performance, as they depended upon the existence and amount of "exempt foreign trade income" which can only be

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[15] See Gary C. Hufbauer, "The Foreign Sales" op.cit., p. 5.
Robert E. Hudec, "Industrial Subsidies: Tax Treatment of Foreign Sales Corporations", in Ernest U. Petersmann and Mark Pollack (eds), *Transnational Economic Disputes: The EU, the US and the WTO* (Oxford University Press, 2003) p. 181.
Asif H. Qureshi and Roman Grynberg, United Sates Tax Subsidies, op.cit., p. 991.
[16] United States – Tax Treatment of Foreign Sales Corporations, Report of the Panel (18/10/1999), WT/DS/108/R, para. 3.2.

generated by the export of US products.[17] As such they fell within the scope of item " e" in the Illustrative List.[18]

As regards the first group of claims, the Communities alleged, in the first place, that IRC section 923 (a), providing that "exempt foreign trade income be treated as foreign source income which is not effectively connected with the conduct of trade or business within the United States", derogated from the rules set out in section 864 of the Code, taking as granted what must be proved case-by-case.[19] Section 864 provides, inter alia, that foreign companies must be taxed at the same rate as US companies on income effectively connected with the conduct of trade or business within the US. The second exemption alleged by the Communities related to the application to FSCs of the anti-deferral rules for controlled foreign corporations under subpart F of the US Internal Revenue Code.[20] The third exemption related to the fact that FSC shareholders were eligible under section 245(c) of the US Code for a 100 percent dividend received deduction for distributions constituted by foreign trade income, whereas, usually, dividends received by US corporations from foreign source income of a foreign corporation were taxable.[21]

The United States rejoined that the FSC measure was no export subsidy, simply because income generated from economic activities outside the territory of the country need not be taxed, as footnote 59 to the SCM Agreement specifies.[22] The US claimed that footnote 59 qualified, that is, limited the scope of item "e" in the Illustrative List indicating that income generated from foreign economic processes need not be taxed, and that the exemption of such income from taxation

[17] WT/DS/108/R, paras 4.293-4.300.
[18] Ibid.., paras 4.363-4.379.
[19] Ibid., para.4.221; paras.4.270-4271.
[20] Ibid.
[21] Ibid.
[22] Ibid., para. 4.363.-4.379.

in any form was not inconsistent with GATT Art. XVI.[23] In particular, the United States remarked that the second sentence of footnote 59, by affirming the arm's length principle, makes it clear that foreign-source income may be exempted from tax or taxed at a lesser extent than domestic-source income, also implying that foreign-source income could be straightaway exempted from tax.[24] The US also noted that the fifth sentence of footnote 59, which excludes measures taken to avoid double taxation from the scope of the Illustrative List, functions as a tax exemption of foreign-source income. In the opinion of the United States, its reading of footnote 59 was confirmed by the 1981 Understanding of the GATT Council, which provided that the exemption from tax of income attributable to foreign economic processes does not constitute forgiveness from "otherwise due" revenue.

As Carmichael points out, the approach of the US and that of the Communities differed in the order in which the SCMA provisions had to be taken into account.[25] The Communities started their analysis with Arts. 1 and 3, subsequently proceeding to the Illustrative List in Annex I. The United States focused in the first place on footnote 59 to item (e) of the Illustrative List, arguing that the footnote made it legally impossible that the FSC programme could be an export subsidy.

The WTO panel opted for the Communities' approach, and examined first whether the alleged tax exemption allowed by the FSC scheme constituted violation of articles 1 and 3(a) of the SCM Agreement. In its assessment the panel

[23] Footnote 59 reads: The Members recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected. The Members reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under their or under the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm's length....Paragraph (e) is not intended to limit a member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member.

[24] WT/DS/108/R, para. 4.365.

[25] Candace Carmichael, "Foreign Sales Corporations – Subsidies, Sanctions and Trade Wars, *VandJj.Transnat'lL.*, 35(2002), p 174.

followed the so-called "but for" test, arguing that the term "otherwise due" refers to the situation that would prevail but for the measures in question. The question was, therefore, "whether, if the FSC scheme did not exist, revenue would be due which is foregone by reason of that scheme"[26] Applying this approach, the panel held that although it is conceivable that "a particular exemption may not in every case result in the foregoing of revenue that is otherwise due", the exemptions identified by the Communities, taken together, involved the foregoing of such revenue.[27] The foregoing, in the panel's opinion, also made the US argument irrelevant, according to which under footnote 59 a country is allowed to exclude from taxation foreign-source income. Indeed, according to the panel, any WTO member "is free to maintain a worldwide tax system, a territorial system, or any other type of system it sees fit", but "it is not free to establish a regime of direct taxation" and then "provide an exemption from direct taxes specifically related to exports".[28]

Having held that the FSC was a subsidy, the panel concluded that the FSC exemptions fall within the scope of art. 3.1(a) of the SCMA as their availability depended upon the sale or lease of export property which, under the relevant section of the US Internal revenue Code, is limited in effect to "goods manufactured, produced, grown or extracted in the United States and which were held for direct use, consumption or disposition outside the country".[29] Having already condemned the measure, the panel abstained from considering the claim of inconsistency of the administrative pricing rules with the general principles governing transfer pricing.

[26] WT DS 108 R., para.7.45.
[27] Ibid., paras 7.99-7.100.
[28] Ibid., para.7.122.
[29] Ibid., para 7.106-7.108.

The opinion of the panel was substantially upheld by the Appellate Body, though with some reservations. On the one hand, the Appellate Body argued that the "but for" test employed by the panel, though fitted to the FSC controversy, was deprived of general validity as "it was easy to circumvent such a test by designing a tax regime under which there would be no general rule that applied formally to the revenues in question, without the contested measures".[30] On the other hand, the Appellate Body agreed with the kernel of the panel's interpretation of SCMA art.1.1(a), stressing that "the term "otherwise due" implies some kind of comparison between the revenue due under the contested measure and the revenue due in some other situation" and that "the basis of the comparison must be the tax rules applied by the member in question".[31]

The Appellate Body also affirmed the panel's reasoning rejecting the US contention that footnote 59 qualified item "e" of the Illustrative List and, therefore, removed the FSC scheme from the scope of art. 3.1(a). In particular the Appellate Body noted that the arm's length principle is not relevant to the question at issue, as it "is unaffected by the choice a Member makes as to which categories of foreign-source income, if any, it will not tax, or will tax less."... as well as by "the choice a Member might make to grant exemptions from the generally applicable rules of taxation of foreign-source income that it has selected for itself" [32]. On the other hand, the Appellate Body refused to entertain the question as to whether the fifth sentence of footnote 59 allowed the FSC scheme as a measure to avoid double taxation of foreign- source income, arguing that the panel had not been requested to judge this issue.[33]

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[30] United States – Tax Treatment for "Foreign Sales Corporations" AB 1999-99. Report of the Appellate Body (24 2 2000) WT DS 108 AB R, para.91.
[31] WT/DS/108 AB R para. 90.
[32] WT DS 108 AB R paras 98-99
[33] Ibid.paras. 101-103.

Both panel and Appellate Body attributed no relevance to the 1981 Decision with respect to the case under review. In particular, the Appellate Body noted that the 1981 Understanding, though a decision binding the parties directly concerned, cannot be ranked among those legal instruments that have entered into force before the date of entry into force of the WTO, which are listed in paragraph I(b) of the language of Annex 1A incorporating GATT 1994 into the WTO Agreement, as it was not legally binding on all the Contracting Parties to GATT 1947. This, in the opinion of the Appellate Body, results from the circumstances surrounding the adoption of the Understanding, and in particular from the statement of the chairman of the Council that adopted the panel reports on the "Tax Legislation" disputes between the US and some EC member states in 1981. The Appellate Body pointed out that the chairman had noted that the adoption of these reports together with the Understanding do not "modify the existing GATT rules in Article XVI:4 as they relate to the taxation of exported goods ...and do not affect the rights and obligations of contracting parties under the General Agreement". Nor, in the Appellate Body's opinion, could the 1981 Decision provide guidance to the WTO in addressing the FSC dispute, as a "decision" within the meaning of Article XVI:1 of the WTO Agreement, thus supporting the US interpretation of footnote 59. The Appellate Body noted that whereas the SCM Agreement has specific provisions that address the relationship between the provisions of GATT 1994 and the SCM Agreement with regard to countervailing duties, they "do not provide explicit assistance as to the relationship between the export subsidy provisions of the SCM Agreement and ArticleXVI:4 of GATT 1994". In the absence of any specific textual guidance, the comparison between the relevant provisions of the SCM Agreement and the Agreement on Agriculture, on the one hand, and of GATT 1994 Art. XVI:4, on the other, shows that the scope of the latter differs substantially from that of the former. The Appellate Body stressed that as regards the SCMA in particular, unlike GATT Art. XVI:4, the Agreement contains an express definition of the term "subsidy" as well as a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of GATT 1947". It also pointed out that the Agreement establishes a much broader prohibition against any subsidy which is "contingent upon export performance", whereas Art. XVI:4 prohibits only those subsidies which result in a lower price for the exported product than the comparable price for that product when sold in the domestic market.

In short, in the view of the panel and of the Appellate Body, the 1981 Decision had been superseded by a new legal environment. The principle it had espoused, in particular the exemption of foreign-source income, was, therefore, subject to the overarching "otherwise due" principle embodied in SCM Art. 1(1).

**3) Play by the rules of the game: did the DSB provide a fair assessment of the FSC measures in light of the treatment of foreign companies in the US tax system?**

According to Wetzel, the FSC measures were nothing more than the Domestic International Sales Corporation revisited and the foreign presence requirement was just a "smoke screen" for activities carried out in the US by American companies.[34] However, it does not seem that the DSB's reasoning premised on the notion that FSCs were just US corporations. What was the outcome of such an approach?

The exegesis of the relevant SCMA articles made by the panel and by the Appellate Body can be accepted. Open to question, however, is their application

[34] Misti L. Wetzel, "Notes & Comments: United States'Tax Treatment for Foreign Sales Corporations", *Temp. Int'l&Comp. L.J.* 16 (2002), p.236.

to the US tax scheme at issue, though it seems that the assessment of the consistency of the FSC measures with the SCMA has a good chance of being the correct one, all facts "taken together", to quote the panel's words.

As noted above, the panel – whose opinion on this particular point was not criticised by the Appellate Body – remarked that "though conceivable that a particular exemption may not in every case individually result in the foregoing of revenue that is otherwise due...the various exemptions identified by the European Communities, taken together involve the foregoing of revenue that is otherwise due". This "taken together" approach is likely to ignore that thriving activity known as fiscal planning, which is based on seizing the opportunities offered by differentials within domestic tax systems and between national tax systems. Such an approach could have devastating results if extended from export-related subsidies to "actionable subsidies" with regard to the multitude of rules and waivers any national tax system provides, even though in such a case there is the buffer of the "specificity" requirement.[35]

The Appellate Body, though endorsing the panel's reasoning, stressed, correctly in our opinion, that there must be some "defined normative benchmark against which a comparison can be made". We submit that such a comparison should imply a three-step process:

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[35] A hypothetical example could give the idea of such difficulties.
Let us suppose that national rules in country A provide that a 20 percent tax rate applies to small and medium enterprises, which are identified by strict requirements. . However, country A also allows accelerated depreciation and exempted reserves for companies engaging in high-tech activities. Given the stage of industrial development in country A, high-tech activities are carried out by few companies in a rather specific sector (e.g. those engaged in the production of PC components). Let us also assume that 1) most such companies are "de facto" small and medium enterprises; and 2) the availability of accelerated depreciation and tax-free reserves results in lower taxation than that generally imposed on small and medium enterprises. Applying the "taken together" approach it is fairly possible that a competing country could successfully claim that the fiscal regime for high-tech companies, by providing a more favourable treatment to a group of companies, usually small and medium enterprises, results in a subsidy under art. 1.1 (a) (1) (ii) of the SCM and, therefore, in an "actionable" subsidy, even though the high-tech companies do not necessarily fall within the SME scope. Be that as it may, the least one can say is that the leeway for country A's fiscal authorities could be severely curtailed.

1) Identifying the tax regime that allegedly applies in the absence of the measure at issue.

2) Verifying whether the cases to which the measure under scrutiny applies would otherwise fall within the scope of the general regime.

3) Assessing whether the presence of particular provisions and waivers in the regime that would otherwise apply allows the adoption of specific measures for particular cases without entailing an open contrast with the prevailing rules.

Confronted with the maze of US international tax rules, the Dispute Settlement Body had, in our opinion, two options:

A) The first option was to consider FSCs just as a tax scheme to grant US exporters a fiscal advantage. They were no foreign corporations but rather foreign establishments of American exporting companies. It would have been rather a challenging endeavour, but nor was it an impossible task, given the host of contradictions that emerge from the income taxation rules for FSCs, if we consider them as foreign corporations. Indeed, considering the FSCs as a sham was an argument put forward by the European Communities, which pointed out that most FSCs were incorporated in US possessions whose fiscal rules are embodied in the US Internal Revenue Code.[36] In such a case it would have been easy to prove that the FSC provisions were in violation of the worldwide principle underpinning the US regime for companies incorporated in the United States. The syllogism would be as follows: 1) FSCs are not real foreign persons but just a fiscal scheme for US companies; 2) as such they should be subject to the general

[36] Further evidence could be drawn from a critical reading of art. 921 of the IRC. The article does not only state, as the Communities complained, that "exempt foreign trade income shall be treated as foreign-source income". It also provides that all foreign trade income of an FSC other than "exempt foreign income and income determined without regard to administrative pricing rules... shall be treated as income effectively connected with a business conducted through a permanent establishment within the US", without allowing evidence to the contrary. Certainly ,not a favourable outcome from the angle of a real foreign company. It could be argued that the FSC regime does not care about the real existence of a foreign corporation but is just a legal arrangement designed to allow some fiscal advantages to US exporting companies, without giving in too great a portion of the revenue cake.

"worldwide income" principle: 3) the FSC measure was shielding some US corporations from "otherwise due" revenue tax.

B) The second alternative would consider FSCs as real foreign persons. In such a case a thorough comparison between the FSC measure and the rules that otherwise apply to the taxation of income accrued to or distributed by foreign corporations is needed, which do not constitute a uniform regime. Such a comparison gives mixed results.

The Communities claimed that the treatment by the FCM scheme of exempt foreign trade as foreign-source income which is not effectively connected with the conduct of trade or business within the United States is inconsistent with the general rule that requires US tax authorities to verify such an occurrence case-by-case. It could be replied however, that the assumption that foreign sale corporations could actually have a trade or business within the US, and in particular a permanent establishment, is rather open to dispute, as, at first sight, they are just a springboard for the sale of US products abroad.[37]

The assessment of the second alleged exemption, should take into account the following elements:

a) Subpart F is a host of anti-avoidance rules aimed at preventing the indefinite deferral of taxation of income connected to economic activities carried on abroad through foreign affiliates. As such it is not an all-encompassing regime and provides differential treatment for various hypotheses. Subpart F measures are far from being a necessary result of the worldwide income regime applied to resident companies, but "involve a further extension of residence taxation, which in a sense is extraterritorial" and "this opens them to the criticism that an excessive tax

[37] See p. 3.

jurisdiction is being claimed".[38] It seems, therefore, that such provisions are not open ended but must be applied within clearly fixed boundaries.

b) Although both Subpart F and the FSC measures deal with foreign affiliates, FSC requirements do not coincide with the provisions of Subpart F that identify controlled foreign corporations for anti-avoidance purposes. In the latter case a foreign subsidiary becomes a subpart F foreign sale corporation if, according to IRC sect. 957 (a), United States shareholders own more than 50 percent of the total combined voting power of the foreign affiliate's stock or more than half of the stock's total value and if, according to sect. 951 (b), a United States' tax payer owns at least 10 percent of the total voting stock. Therefore, if eleven American individuals or companies own equal interests in a foreign corporation, the latter is not a controlled foreign corporation. To the contrary, pursuant to IRC sect. 922 (a) (B), the FSC could not have more than 25 shareholders. The gap between 10 and 25 is not a trifle. Actually, as Wetzel remarks, there is no statutory requirement that an FSC be affiliated or controlled by a US corporation.[39]

Of major weight is the third exemption on which the Communities grounded their claim: under the FSC measure the parent of an FSC is not taxed on dividends received that are derived from the foreign trade income of the FSC. However, if we look at the economic impact of the exemption it must be noted that, except for foreign companies within the scope of Subpart F, US parent corporations can avoid taxation by US authorities provided that their foreign affiliates' income is not repatriated as dividend.[40]

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[38] Sol Picciotto, International business taxation: a study in the internationalization of business regulation (London: Weidenfeld and Nicholson, 1992), p.145.
[39] Ibid., p.229.
[40] See Gary Clyde Hufbauer, "International", op.cit., p.3.

In short, the panel claimed to pursue a strictly legal analysis of the FSC measure in relation to the main blocks of US international revenue law: but it ended up relying on an economic comparison between the FSC measure and a lump of rules referring to the treatment of income connected with foreign activities. It recognised that FSC rules might not in all cases result in more favourable tax treatment than that outside the FSC scheme, but argued that taken together the "scheme" resulted in a situation where certain types of income are shielded from taxes that would be otherwise due.[41] It failed, however, to investigate whether there is just an occasional overlap of the FSC rules with other more stringent rules, as often happens in revenue law, or whether the hypotheses of income production and distribution covered by the FSC measure were entirely covered by other provisions (the source rules, the conduct of a business or trade within the US, Subpart F and so on) and whether the former was a derogation of the latter.

It is also arguable that the failure to address these questions satisfactorily is the result of the inability of the DSB to provide an interpretation of the term "otherwise due" that could overcome the opaqueness of the SCM text.[42]

**4) The third attempt: the ETI Act**

At any rate, the Dispute Settlement Body's verdict had already set the process in motion, as the deadline for the imposition of sanctions in the absence of compliance was approaching. Some few months after the decision the United States proposed to repeal the FSC legislation with an elective tax measure, known as Eligible Foreign Corporation (EFC). The proposed regime would subject all manufacturing income of US corporations and their affiliates, whether domestic

[41] WT/DS/108/R, paras.7.100-7.101
[42] Robert E. Hudec, "Industrial" op.cit. p. 188

or foreign, to a reduced marginal rate of 29%, subject, however, to the option of the US parent company. Nonetheless, the new regime preserved the 50 percent domestic content requirement and the special administrative pricing rules. Sensing strong opposition on the part of the Communities, and unwilling to start a trade war with the EU at the very end of the Clinton Presidency, the Democratic Administration put forward another tax reform to repeal and replace the FSC regime.[43] The FSC Repeal and Extraterritorial Income Exclusion Act (ETI Act) was signed into law (P.L. 106-519) by President Clinton on November 15th. 2000.

This time, the key to comply with WTO requirements, while preserving the benefit afforded by the DISC and FSC regimes was found in the "selective" incorporation of the territorial principle in US tax law also with regard to US taxpayers. Relying on the statement of the Appellate Body holding that a WTO member is free not to tax any particular category of revenue it wishes, the US lawmakers envisaged a modification of the scope of "gross income", which defines the outer boundaries of US income taxation, excluding certain activities referred to as "extraterritorial income". The House Committee pointed out that "the activities giving rise to "extraterritorial income" involve real economic activity, or economic processes performed outside the United States". On the other hand, the Committee expressed the view that "it is appropriate to exempt certain forms of extraterritorial income from the exclusion", having care, however, to emphasise that "the taxation of certain forms of extraterritorial income is an exception to the general rule of not taxing extraterritorial income"[44]

Thus, the ETI Act amended the Internal Revenue Code, first by inserting a new section 114, entitled extraterritorial income, which, under the heading

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[43] See Harold S. Peckron, "Uniform Rules of Engagement: The New tax Regime for Foreign Sales", *Hastings Int'l Comp. L. Rev.* 25(2001) p. 14.
[44] US Code Congressional and Administrative News. Legislative History. *FSC Repeal and Extraterritorial Income Exclusion Act of 2000.* House Conference Report 106-845.

"exclusion" provided that gross income does not include extraterritorial income but under the heading "exception" added that the exclusion "shall not apply to extraterritorial income which is not qualifying foreign trade income". Therefore, extraterritorial income results in the reduction of the taxpayer's taxable income only if it is "qualifying extraterritorial income". The latter was defined by IRC sect. 941, as amended by the ETI Act, with respect to specific type transactions, such as the taxpayer's choice of the following options: a) 30 percent of the foreign sale and leasing income derived by the taxpayer from the transaction: b) 1.2 percent of the foreign trade gross receipts derived from the transaction; and c) 15 percent of the foreign trade income derived from the transaction. Sect. 941 provided that "foreign trade income" is the taxable income attributable to "foreign trade gross receipts". According to the same section, "foreign sale and leasing income" is income derived in connection with the lease or rental of "qualifying foreign trade property", or income allocable to the solicitation, the negotiation or the making of the sale or lease contract, if carried out outside the US, as well as to related activities, such as advertising, processing of customer orders and transportation of the goods outside the US. IRC sect. 942 defined "foreign sales gross receipts" as the gross receipts accruing from the sale or other form of disposition and from the lease or rental of "qualifying foreign trade property", as well as from some related activities.

Two requirements, however, were to be fulfilled for the income to become qualified. Firstly, as noted above, it had to involve "qualifying foreign trade property". According to sect. 943, the latter refers to: 1) goods that are manufactured, produced, grown or extracted within or outside the United States; 2) that are held primarily for sale, lease or rental, in the ordinary course of trade or business for consumption or use outside the United States: 3) and provided that no more than 50 percent of their fair market value is attributable to articles originated outside the United States, or to direct costs for labour performed outside the US. Hence, the requirement largely reproduced the FSC "export property" provision. On the other hand, pursuant to sect. 942 (b), qualification was subject to a "foreign economic process requirement" which was fulfilled if the taxpayer (or any person acting under contract with the taxpayer) participated outside the US in the solicitation, negotiation or making of the contract relating to the transaction, and a specified portion of the "direct costs" of the transaction were attributable to activities performed outside the US.

Unlike the FSC measure, the new legislation did not require the establishment of any foreign corporate person. The benefit was granted either to US taxpayers, whether natural persons, corporations, or partnerships, or to a foreign corporation. In the latter case the production process could be carried out entirely outside US borders. However, given the 50 percent domestic content requirement, it was to be expected that the manufacturing companies would mostly be foreign subsidiaries of US companies.

As a result of the application of a principle other than that of worldwide income, no deductions or tax credits are permitted against exempted extraterritorial income. Finally, the benefit was optional, that is, the ETI measure permitted all the above-listed taxpayers to have qualifying income taxed according to the ETI provisions, or taxed according to the general principles.

### 5) The ETI Act under DSU Art. 21.5 scrutiny

American scholars did not agree on the question of the ETI Act being consistent with WTO requirements. Peckron argued that the ETI Act was WTO consistent, as it brought the territorial principle into US tax law.[45] On the other hand, Ostergaard warned that the FSC replacement legislation "still grants a tax break from payment of direct tax based on exports", while as far as the US is concerned "in the category of exports, the fundamental principle is that tax breaks cannot be export contingent".[46] She proved to be right.

Actually, an attentive observer, although not particularly familiar with the intricacy of US Revenue Code and the SCMA, would not fail to notice two points: 1) The reform of the US IRC was based on a selective application of the extraterritoriality principle. In other words, the reformed concept of "gross income" embodied in section 114 was not entirely encompassing the territorial principle allegedly applied by the majority of European countries. Certain kinds of income were still subjected to the worldwide rule. Thus the keen observer would have the feeling that, paraphrasing Orwell's Animal Farm, some forms of income are more "extraterritorial" than others. 2) The attentive observer will also remark that the benefit conferred by the new regime is, at least to a certain extent, linked to some US content requirements for articles sold abroad, which, at first view, is akin to the FSC provision that contributed to the condemnation of such measures.

Leaving aside legal reasoning and relying only on conventional wisdom, the keen observer could easily foresee that the ETI rules can run into trouble when they are vetted by an examiner who focuses on the implementation of a decision that claimed to be based on the banning of favourable discriminatory practices and on the principle of no public boost for export.

The European Communities very soon claimed that the ETI Act was inconsistent with US obligations under the ASCM, the AA, and GATT 1994, and requested that the matter be referred to the original panel pursuant to Art. 21.5 of

[45] Harold S. Peckron, "Uniform Rules, op.cit., p.36.

[46] Sarah Ostergaard, "The Third Strike: The United States' attempts at Achieving Tax Parity Between its Income Tax and European Value-Added Tax" *J.Legis* 27 (2001) p.437.

the Dispute Settlement Understanding.[47] With specific regard to the Agreement on Subsidies and Countervailing Measures, first the panel and then the Appellate Body, focused on three issues: the inconsistency of the Act with art. 1.1 of the Agreement; its inconsistency with art. 3.1; and the role of footnote 59.

*Art. 1.1 of the SCM Agreement*

The European Communities contended that the exclusion of certain extraterritorial income from gross income gives rise to a financial contribution in the form of foregoing of revenue that is otherwise due, as there is no general US taxation rule excluding extraterritorial income. On the contrary, in the Communities' view, section 114 was a limited exemption that confirms the US general rule of worldwide taxation of income, which is, thus, the benchmark for assessing the situation prevailing if the conditions established by the ETI Act are not fulfilled.[48] The United States replied that the ETI Act redefines the concept of gross income, providing the new domestic standard for US taxation since section 114 must be viewed as an integral part of IRC sect. 61, thus replacing or at least limiting the worldwide rule.[49]

The panel, having reasserted the validity of its "but for" approach, though, prudently, with specific reference to the FSC – ETI dispute, argued that the basis for comparison under SCMA article 1.1(a)(1)(ii) must be the tax rules applied by the concerned WTO member. Starting from this remark, the panel noted that, by treating as non-taxable certain income on the basis of highly selective conditions, the Act effectively carves out such an income from the situation that would prevail where the Act's requirements are not fulfilled, in particular where the

[47] On the function of art. 21.5 of the DSU see Chp. IV, note 72.
[48] United States – Tax Treatment for Foreign Sales Corporations. Recourse to Article 21.5 of the DSU by the European Communities. Report of the Panel (20 8 2001). WT DS108 RW, Annex A-1paras 57,61.
[49] WT DS108/RW, Annex A-2 paras 166-169.

goods are for use within the United States or where they do not satisfy the foreign content limitation.[50] As regards the US argument that the ETI Act's revised definition of gross income is the prevailing domestic standard, the panel noted that "taken to its logical extreme, this US argument would be that a government could opt to bestow financial contributions in the form of fiscal incentives simply by modulating the "outer boundary" of its tax jurisdiction or by manipulating the definition of the tax base "to accommodate any "exclusion" or "exemption" or "exception" it desired so that there could never be a foregoing of "otherwise due" revenue.[51] The panel also noted that the ETI measure confers a benefit as, being able to exclude qualifying foreign trade income from its gross income, the taxpayer is better off than in the situation where the conditions for obtaining the tax treatment under the Act are not fulfilled.[52]

The panel's finding was upheld by the Appellate Body. The latter, however, confirming its opinion that the "but for" test is not the only way of implementing art. 1.1(a)(1)(4), nor, perhaps, the best one, argued that "given the variety and complexity of domestic tax systems, it would usually be very difficult to isolate a 'general rule' of taxation and 'exceptions' to that general rule" and, therefore, "the panels should seek to compare the fiscal treatment of legitimately comparable income". The AB explained the idea of comparability saying that it might not be appropriate to compare taxation of sales income with the taxation of employment income, or taxation of foreign-source income in the hands of a domestic corporation with taxation of such income in the hands of a foreign

[50]Ibid., paras. 8.23 – 8.30.
For a dissenting opinion of an American scholar see Ashley Redd Commins, "The World Trade Organization's Decision in United States – Tax Treatment for "Foreign Sales Corporations": Round Three in the Transatlantic Tax Dispute", *N.C.J. Int'l L.&Com. Reg.* 27(2001), p.379.
[51] WT/DS108/RW, para.8.39.
[52]Ibid., para.8.46..

corporation.[53] The rather open-ended approach suggested by the Appellate Body raises, however, some doubts, as it fails to note that in the complex world of tax legislation legitimate comparability does not result only from objective (economic) factors, but is strongly influenced by the labels put by the fiscal legislator. In short it does not withstand analysis when it is confronted with complex fiscal schemes. One example could be the treatment of partnership in many legal systems, which in spite of strong similarities with a public company is not subject to corporate tax. Even greater doubts stem from the treatment of groups of companies. Many scholars have pointed out that groups are in effect one business, notwithstanding that as a matter of law each company has a separate legal personality.[54] However, those national regimes that recognise groups of companies for fiscal purposes link their recognition, which entails fiscal benefits, to threshold rates in the relationship between member companies. Such thresholds (generally measured with reference to capital or voting rights) are established according to a rule of thumb which varies from country to country: sometimes 75 percent, sometimes 70 percent, sometimes less. Some countries, like the UK, have various thresholds to which are linked different forms of fiscal advantages. Below the threshold the companies are subject to the regime that would "otherwise apply". Are groups of companies, recognised for fiscal purposes, a covered form of fiscal subsidy, which falls within the scope of SCM art 1(1) ? Hudec, who looks rather critically at both panel report and AB report, remarks that the Appellate Body's literal reading of the word "otherwise" seems to have no connection with other concepts of subsidy. He adds that the "but for" test "did at least fit the common-sense notion of subsidy, by asking whether the

[53] United States – Tax Treatment for Foreign Sales Corporations. Recourse to Article 21.5 of the DSU by the European Communities. Report of the Appellate Body (14/2/2002). WT/DS108/AB/RW, paras 90-92.
[54] Adrian Sheepwright and Elisabeth Keeling *Revenue Law* (London:Blackstone Press Ltd, 1997), p. 614.

government was handing over revenue that would normally have been collected" whereas the tax treatment of comparable income has no visible connection to such a question.[55]

However, in spite of the ambiguity generated by the Appellate Body's approach, it appears from the foregoing examination that the DSB was correct in arguing that the new US fiscal scheme affords positive fiscal discrimination to a particular group of activities.

*Art.3.1 (a) of the SCM Agreement*

The European Communities contended that, with respect to goods entirely produced in the United States, the measure falls within the scope of art. 3.1(a) of the SCM Agreement, as the subsidy is only granted to profits from export transactions and, therefore, is export contingent.[56] The United States on the other hand, argued that the Act's exclusion of "extraterritorial" income cannot be viewed as conditional on exports since such income can be earned in many ways besides exporting US goods.[57]

Upholding the panel's opinion, the Appellate Body recalled its statement in the "Canada-aircraft" case, according to which SCMA art. 3.1(a) posits that the granting of a subsidy must be conditional on export performance.[58] The Appellate Body also noted that the ETI measure provides two forms of tax exemption, although both exemptions are conditional on direct use, consumption or disposition outside the United States. As regards property produced in the US, the requirement is necessarily tantamount to exporting the goods concerned. This is not, however, the case for property produced outside the US. Given the

[55] Robert E. Hudec, "Industrial Subsidies", op.cit p. 198.
[56] WT/DS108/AB/RW, para. 50
[57] Ibid., para. 29.
[58] Ibid., para. 112.

independence of the hypotheses in section 943 of the IRC, the fact that subsidies granted to enterprises outside the US might not be export contingent does not prevent export contingency with regard to goods produced inside the US. Conversely, the export contingency for subsidies bestowed on US goods has no bearing on whether there is an export contingent subsidy on goods produced outside the US.[59]

*Footnote 59 to Annex I*

The United States also contended that the ETI Act falls within the scope of the fifth sentence of footnote 59 to the SCM Agreement, which limits the scope of art. 3.1(a) carving-out from export subsidies those measures which are aimed at preventing double taxation of foreign-source income.[60] The US argued that footnote 59 should be read in conjunction with footnote 5 to the SCMA which provides that "measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement". In the US opinion, footnote 5 applies not only to those cases that are explicitly excluded from the Illustrative List of export subsidies, but also to those cases that turn out to be outside the scope of any of its items.[61] From the foregoing the US draws the conclusion that the burden of proving that the ETI measure is consistent with footnote 59 is not on the defendant. Instead, the burden of proof is on the plaintiff claiming violation of art. 3.1(a).[62] Upholding the panel report, the Appellate Body acknowledged that footnote 59 allows WTO members to grant special fiscal treatment to foreign-source income in order to alleviate the burden of double taxation on its taxpayers. However, as Von Hoff points out, the AB did not acknowledge that footnote 59 was an exception to the general definition of

[59]Ibid., paras 115-119.
[60] WT/DS108/RW – Annex A-2, para.170.
[61]Ibid., para.173 For an application of this viewpoint to other cases (Brazil- Export Finacing programme for Aircraft), see Chp. IV, p. 343 et seq.
[62] WT/DS108/AB/RW, para 124.

subsidy. Rather, it viewed the fifth sentence only as a justification that prevents SCM Agreement's sanctions when applied to specific cases.[63] As such the fifth sentence of footnote 59 only constitutes an affirmative defence that justifies a prohibited export subsidy when the measure in question is taken to avoid the double taxation of foreign-source income[64] It, therefore, held that the burden of such proof rests on the responding party.[65]

Finally, the Appellate Body addressed the question – negatively answered by the panel – as to whether the ETI Act aims at preventing double taxation. It maintained that the US had failed to provide comprehensive proof that the ETI Act falls within the scope of footnote 59.

The Appellate Body pointed out, in the first place, that the tax benefit allowed by the fifth sentence of footnote 59 must redress an objective disadvantage stemming from the fact that the same income is potentially subject to double taxation. This results from the fact that the income in question is "foreign-source income", a term that in the Appellate Body's opinion, refers to activities conducted in a foreign state so that the income could properly be subject to tax in that state.[66] Turning to the ETI Act, the Appellate Body noted that, pursuant to IRC section 942 (b), recognition of "extraterritoriality" is conditional on the participation, outside the US, in activities such as solicitation, negotiation or contract stipulation, as well as on the fact that 50 percent of certain of transaction costs must be attributable to activities performed abroad. However, it also pointed out that in two of the three alternatives set out in section 941 of the Internal Revenue Code, the ETI measure fails to distinguish between income originating abroad and income produced by activities carried out in the US.

[63] Carrie Anne Von Hoff, "Avoiding a Nuclear Trade War: Strategies for Retaining Tax Incentives for U.S. Corporations in a post FSC World", *Vand. J. Transnat'l L.*, 35 (2002) p. 1362.
[64] WT/DS108/AB/RW, paras. 131-133.
[65] Ibid., paras. 134.
[66] WT/DS108/AB/RW, paras. 140;145.

Indeed, "foreign trading gross receipts" under section 942 (a) (1) and "net foreign trade income" under section 941 (a) (1) encompass proceeds arising both from activities carried out in the United States, such as R & D and manufacturing, and, in the final stage, from activities conducted abroad. In these cases, therefore, "qualifying foreign trade income" simply results in a "fixed percentage that bundles together both domestic and foreign-source income"[67] Consequently, in such cases there is no objective criterion on which double taxation avoidance can rely. Only in the residual hypothesis providing, under sect 941 (a) (1) (A), the taxation of 30 percent of the income generated by activities carried out abroad for the sale of goods, is a proper partition between domestic and foreign activities.

In short, the attempt of the United States to modify its tax regime while preserving its basic goals backfired. The Panel and the Appellate Body, engaging this time in a thorough analysis of the US tax reform, had an easy time in proving that headings are not enough to change legal substance. In their view the ETI reform was not the radical shift to the territorial regime the US had claimed. Instead, the extraterritorial income at the heart of the reform was, in their opinion, just a provision selectively carved out from the still dominant parameter of worldwide income. Since the exception was prevalently aimed at buoying exporters of US goods, it was not covered by footnote 59 as, in most cases, it was not directed at avoiding double taxation.

**6) The uncertain outcome of the controversy**

Despite the entry into force of the ETI Act, on 17th. November 2000, the European Communities requested authorization from the DSB to suspend concessions to the amount of US $ 4,043 million per year. The United States

[67] Ibid., paras. 154-156.

objected to the appropriateness of the level of suspension of concessions proposed by the European Communities and requested that the matter be referred to arbitration, under article 22.6 of the DSU and article 4.11 of the SCM Agreement.[68] On November 28th, 2000, however, the parties agreed to suspend the arbitration proceeding until the adoption of the DSU art.21.5 panel Report. After the adoption of the panel and Appellate Body reports, on 29th, January 2002, the Arbitrator resumed its work and upheld the amount of countermeasures proposed by the European Communities.[69]

In the aftermath of the DSB defeat, American scholars and politicians examined the options for joining WTO compliance and fiscal incentives for exports.

One of the proposals involved converting the corporate income tax into an indirect tax, thereby complying with the WTO rules that allow deduction of the latter on exports. Thus income tax would be partially replaced by a consumption tax or in particular Valued Added Tax (VAT), so as to align the US system to that of its European trading partners. It was noted, however, that replacing income tax with VAT would have enormous administrative costs as Congress would have to re-work the entire US tax system. It was also pointed out that the adoption of a VAT system would move away from the progressive nature of the American tax system as VAT is a regressive tax having greater impact on those consumers who have a higher propensity to consume, that is the poor.[70]

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[68] Art. 4.11 of the SCM Agreement provides that "In the event a party to the dispute requests arbitration under paragraph 6 of Article 22 of the Dispute settlement Understanding ("DSU"), the arbitrator shall determine whether the countermeasures are appropriate".
Art. 22.6 of the DSU provides in relevant parts that "when the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations….However if the member concerned, objects to the level of suspension proposed…the matter shall be referred to arbitration".
[69] United States – Tax Treatment of Foreign Sales Corporation – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement. Decision of the Arbitrator (30/8/2002). WT/DS108/ARB, para. 8.1.
[70] See, Ronald D. Sernau, The Foreign Sales", op.cit. p. 1201.

A further option was for the US to adopt a fully-fledged territorial tax approach. It was argued, however, that the territorial regime could have two drawbacks: 1) encouraging US companies to move their activities outside the US to lower tax jurisdictions, thus decreasing US exports and 2) reducing US revenue collection. On the other hand, the Republican administration could accept such an alternative as a means of decreasing the tax burden on US corporations.[71]

In this context proposals were made for the introduction of safety valves, if not thorough amendments, in the current WTO dispute settlement mechanism. In general terms it has been suggested that in the absence of established legislative rules governing an issue or where there is substantial ambiguity in the existing rules, a non-binding recommendations process should be provided.[72] Another possibility could be encouraging compensation in lieu of removing trading practice that a panel considers illegitimate.[73]

Not to comply with the WTO decision and to accept the imposition of sanctions was an option which was by and large discarded, at least officially, for a number of reasons. Firstly, preserving the status quo would attract legitimate retaliation from US trade partners. Secondly, not to abide by international rules would undermine US leadership not only in the economic field but first and foremost in the political one.[74] This solution, however, was not entirely rejected. As Von Hoff remarks, many tax experts submitted that until there was a new statute in force, corporations had no choice but to go on accepting the Foreign Sales Corporations Replacement Act.[75] An American commentator argued that it was unlikely that the US would accept to pay the sanctions imposed by the

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71 John Seiner, "Beating Them at Their Own Game: A Solution to the US Foreign Sales Corporation Crisis", *Minn. J Global Trade*, 11(2002), p. 413.
72 Alan Wm Wolf, "Problems with the WTO Dispute Settlement", *Chi. J. Int'l L.* 2(2001), p.422.
73 Ibid., p. 423.
74 John Seiner, "Beating Them" op.cit., *Minn. J Global Trade*, 11(2002), p. 408.
Also Marc Rosemberg, "How a Taxing Problem Has Taken its Toll: A Common Person's Guide to an International Taxation Dispute", *B.U. Int'l L.J.* 20 (2002), p. 30.
75 Carrie Anne Von Hoff, "Avoiding a Nuclear", op.cit. p.1370.

European Communities, quoting the US Trade Representative Robert Zoellick who compared EU sanctions of the magnitude proposed to dropping a nuclear bomb on the global trading system.[76] This means that at the time the US was sceptical about the willingness and ability of the EU to apply effective retaliatory measures. It was also foreseeable that even if at the end of the day the United States was going to comply with the decision of the DSB, compliance would take place after a long period in which the acceptance of sanctions would be weighed up as a possible best option, and above all just as part of a wider overhaul of the US fiscal regime, in which several interest groups would make their voice heard. As Showalter remarks, "the WTO's dispute resolution system was premised on the notion that legislatures are capable of making rational decisions". To the contrary, as public choice theory points out, policymaking "results from compromise, conflict and confusion among officials with diverse interests and unequal influence".[77]

The decisive factor was the determination showed by the European Communities in applying the sanctions, if necessary, and accepting their economic impact on both US exporters and EU consumers and producers. On March 1st, 2004 the European Union started to impose extra duties, but at a rate of 5 percent, escalating by 1 percent per month to a maximum of 17 percent to be reached in March 2005. The tariffs had the potential of amounting to $ 46 billion over a period of 10 years.[78] The Communities thus showed that it was acting, but the threat of a progressive increase of the duties on American exports left the buck on the US side.

76 Candace Carmichael, "Foreign Sales Corporations", op.cit., p. 206.
77 Michael Showalter, "A Cruel Trilemma: The Flawed Political Economy of Remedies to WTO Subsidies Disputes", *Vand.J.Transnat'l L.*, 37 (2004), p. 605
78 See Colleen Klanchnik, "United States – European Union Dispute on Foreign-Source Income, Export Activity, and the Extraterritorial Income Exclusion Act, *Hofstra L.Rev.* 33 (2004), p. 363.

In September 2004, in the context of a wider overhaul of US tax policy, section 101 of the American Job Creation Act of 2004 (PL 108-357) repealed the "exclusion for extraterritorial income".[79] Other provisions of the Act replaced the ETI benefit with US $ 138 billion in tax relief for domestic manufacturing.

The repeal, however, was far from absolute. Firstly, pursuant to the "transition provision" in section 101(d) of the Act in the period between 1st. January 2005 and 31st. December 2006, the ETI scheme remained in place on a reduced basis (80 per cent in 2005 and 60 per cent in 2006). Secondly, the Conference Agreement introduced a subsection 101(f) which indefinitely grandfathered the ETI scheme in respect of those transactions carried out in the ordinary course of trade pursuant to a binding contract and an unrelated person, already in effect on 17th. September 2003 (the last day before the introduction of the bill before the US Senate) and at all times thereafter.[80] Finally, Section 101 of the Jobs Act did not repeal section 5(c)(1) of the ETI Act, thus indefinitely grandfathering FSC subsidies in respect of certain transactions which benefited from FSC subsidies. In short, a grandfathering of a previous grandfathering.

The European Communities moved to lift the sanctions it had imposed on US exporters while still arguing that the phase-out scheme and in particular the "grandfathering" provisions favoured exporters of capital goods that had long delivery times including Boeing, Microsoft, Motorola and Caterpillar. Soon after a new Art. 21.5 complaint was lodged.

The United States did not directly contest that the above-mentioned measures were not inconsistent with the SCMA but based its defence on

[79] See Internal Revenue Acts – 2004. Public Law 108-357 (H.R. 4520) October 22nd. 2004. *American Jobs Creation Act of 2004. An Act to Amend the International Revenue Code to remove impediments in such Code and make our manufacturing, services and high-technology business and workers more competitive and active both at home and abroad.*

[80] U.S. Code Congressional and Administrative News. 108th Congress – Second Session – 2004. Legislative History. *American Jobs Creation Act of 2004.* House Conference Report 108 – 755. p. 252.

procedural points. In particular, the US argued that there was no recommendation or ruling under Article 4.7 of the SCM Agreement resulting from the 2002 Article 21.5 compliance proceedings to withdraw the ETI subsidy, as on that occasion the Appellate Body recommendations did not pertain to the ETI Act but just called for full implementation of the rulings in the original "Foreign Sales Corporations" proceedings, which were passed before the ETI Act tax exclusion.[81] SCMA Art. 4.7 provides that a recommendation for the immediate withdrawal of a subsidy must specify the time period within which the measure must be withdrawn.

The panel rejected the argument of the United States pointing out that the operative recommendations and rulings remained those adopted by the DSB in the original proceedings in 2000 with regard to the FSC statute and that the 2002 Article 21.5 Panel and Appellate Body reports, as adopted by the DSB, found that the ETI scheme had failed to fully withdraw the prohibited subsidies. There was, therefore, no need for further recommendations and rulings.[82]

The panel also rejected the United States' defence that the purpose of fiscal transition provisions contained in sections 101(d) and (f) of the Jobs Act was to provide, like most transitional rules included in US tax legislation, a "smooth and orderly transition in order to prevent the repeal of tax legislation from having a retroactive effect on taxpayers who entered into arrangements in reliance on pre-repeal law".[83] Giving no relevance to public choice theory with regard to international law commitments, the panel held that the WTO obligation to withdraw prohibited subsidies is unaffected by contractual obligations that Members may have assumed under their domestic legislation or regulation and

[81] United States –Tax treatment for 'Foreign Sales Corporations' – Second Recourse to Article 21.5 of the DSU by the European Communities – Report of the Panel (30.9.205).
WT DS108 RW2, para. 7.11.
[82] Ibid., paras 7.52-7.53.
[83] Ibid. para.7.10.

that such an obligation cannot be affected by contractual arrangements made by private parties in reliance on laws conferring prohibited export subsidies.[84]

History will tell if the United States will be willing to comply and, even more importantly, in which domestic and international context such compliance will occur.[85]

## Conclusion

The FSC – ETI dispute is a turning point in the history of multilateral trade agreements. Never before has the impingement of international rules on national regimes been so great, as for the first time it has reached the bedrock of state autonomy: tax legislation.

It is debatable whether the U.R. parties, and the US in particular, realised that the SCM Agreement was to be the thin end of the wedge by including the foregoing of revenue that is otherwise due among the basic component elements of subsidy. It is true that item "e" in the Illustrative List of Export Subsidies dates back to the 1960s, but its scope seems to have been less wide. The reading of the item makes it clear in the first place that there must be a specific link with export activities. But above all the item appears to be concerned with specific measures which result in a waiver to specific rules. Its reference to "exemption, remission or deferral of direct taxes or social charges paid or payable by industrial or commercial enterprises" gives the idea that the amount due from the taxpayer is easily calculated, being based on rules that do not overlap or conflict with concurrent sets of provisions. The reference to what is "otherwise due" in art. 1.1 (a) (1) (ii) of the SCMA is much more open-ended and could refer to wide-scope

[84] Ibid. para.7.66.
[85] The panel's finding was upheld by the Appellate Body in February 2006.
United States – Tax Treatment of Foreign Sales Corporations – Second Recourse to Article 21.5 of the DSU by the European communities – AB - 2005-9 – Report of the Appellate Body (13/2/2006). WT/DS108/AB/RW2, para.100.

components of the often complex national taxation fabric. As noted, the challenge to national fiscal autonomy is not limited to export subsidies but could extend to actionable domestic subsidies under the cloak of fiscal benefits.

The task that has confronted the DSB in the FSC-ETI dispute – and could confront it in the future – is the assessment of the scope of the fiscal rules under scrutiny: whether the measures at issue are just a waiver from wider rules or are an autonomous basic element of the fiscal fabric. In the FSC case the DSB analysed the provisions of the SCM Agreement at length but, in our opinion, refrained from carrying out an in-depth assessment of FSC provisions vis-à-vis other US international taxation rules from which they were alleged to derogate. In its aftermath, the ETI case, panel and Appellate Body coupled the interpretation of the SCM Agreement with an in-depth analysis of the new American legislation. The "moral" of the reports is that we must look beyond the label provided by the government concerned and assess the real goal of the measure under review.

Another lesson we can draw from the FSC-ETI saga is that WTO members, when it comes to questions that hit the hard core of national sovereignty, as in the case of taxation, are bound to engage in a last ditch defence of their autonomy over multilateral rules. After thirty years of legal dispute the DISC – FSC – ETI saga is not completely over.

# CHAPTER VI

## THE US COUNTERVAILING DUTY REGIME AFTER THE URUGUAY ROUND

### 1) Introductory considerations.

In chapter III we provided an overview of the concepts that have gradually moulded the US countervailing duty regime prior to the Uruguay Round and in the following chapter we focused on the process by which most of these concepts have been embodied in the new multilateral rules on subsidies and countervailing measures and on the impact of the American perspective on the interpretation of such rules by the WTO Dispute Settlement Body. In this chapter we go back to the US CVD regime to assess whether it has changed after the adoption of the Uruguay Round Agreement Act (URAA) and in which direction it has moved.

Given that the relevant provisions of the SCM Agreement, as shown in Chapter III, largely track US legislation and administrative practice, the Uruguay Agreement Act made few significant changes with respect to CVD proceedings in the United States. On the other hand, it is arguable that the United States tried to preserve and sometimes develop its countervailing duty heritage also where WTO rules may be inconsistent with US practice, as borne out by the fact that the US has been the defendant in many countervailing measure cases entertained by the WTO Dispute Settlement Body.

The task for the analyst is not easy as the present US CVD regime relies not on a single instrument but on three, that is, the Uruguay Round Agreement Act (URAA), the Statement of Administrative Action (SAA) and, at a lower level, the Final Countervailing Duty Regulations.

The implementation of the new WTO rules on countervailing measures is embodied in the Tariff Act of 1930, as amended by the URAA. The URAA, however, includes, as an integral part, a Statement of Administrative Action (SAA), which not only describes relevant administrative actions aimed at implementing WTO Agreements, but also explains how the implementing bill and the action carried out by the Executive affects prior US law. As stated in the introduction, the SAA "represents an authoritative expression by the Administration concerning its view regarding the interpretation and application of the Uruguay Round Agreements, both for purposes of international obligations and domestic law".[1] But the Statement is not only binding for the Executive. Indeed, an SAA is typically required when the US Executive submits legislation implementing a trade agreement to the US Congress that will be considered under so-called "fast-track" procedures. Specifically, the SAA was a requirement of the Omnibus Trade and Competitiveness Act of 1988, in which Congress granted negotiating authority to the President and provided for "fast-track" Congressional implementation of trade agreements. Congress approved the SAA in the URAA, providing that "the statement of administrative action approved by the Congress shall be regarded as an authoritative expression by the United States concerning the interpretation and application of the Uruguay Round Agreements and this Act in any judicial proceeding in which a question arises concerning such interpretation or application."[2] As expected, in most cases the SAA stressed the continuity of the new rules with the previous legislation.

In the second place, though at a lower level, the analysis of the US regime must take into account the final countervailing duty regulations (also called final rule) adopted in 1998 by the Department of Commerce as administering authority "to conform to the Uruguay Round Agreements Act", and authorised by Congress.[3] Previously there were no implementing regulations on countervailing measures. In its investigations the Department particularly relied on its 1988

[1] United States Code Congressional and Administrative News. *The Uruguay Round Agreements Act – Statement of Administrative Action (P.L. 103-465) p. 656.*
[2] *URAA*, Section 102, codified at 19 *USC*, Section 3512(d)
[3]CountervailingDuties;FinalRule–19CFR,Part.351-63FR65347.Nov.1998. www.ia.ita.doc.gov/regs/98-30565.txt

Proposed Regulations, but they were never formally adopted. The final regulations of November 1998 codified previous administrative practices, but also established new criteria that Commerce had been working out in the years following the URAA.

The interpretation of the US countervailing duty regime must, therefore, deal with a three-layer set of statutory rules, interpretative statements, and administrative regulations. As noted above, the analysis also assesses the continuity of the new countervailing regime with the CVD measures prior to the URAA and their actual consistency with the Uruguay Round rules they claim to implement in the United States.

**2) Definition of Subsidy in the US perspective.**

The interplay between the Tariff Act of 1930, as amended, the SAA and the regulations of the Department of Commerce is illustrated by the definition of subsidy.

Tracking the language of SCMA Art. 1, section 771 (5) (B) of the Tariff Act[4] states that a subsidy exists when the government or any public body within the territory of a country provides a financial contribution; any form of price and income support; or makes payments to a funding mechanism or entrusts or directs a private body, where the provision of such a contribution normally would be vested in the government. With reference to the latter hypothesis, however, the SAA, referring to the distinction between direct and indirect subsidy in GATT art. VI, provides that the "entrust or direct" standard must be interpreted broadly and could encompass those situations in which a public authority, either through statutory or administrative action, imposes a measure from which a benefit results

[4] 19 USCA § 1677 (5) (B)

for the industry under investigation.[5] Thus, according to the Statement, where the government acts through a private party to provide a benefit, the law should be administered on a case-by-case basis but the standard should not be narrower than that of the prior US standard finding of indirect subsidisation as applied in investigations such as Certain Softwood Lumber Products from Canada and Leather from Argentina.[6] Therefore, in contrast with the European Union's standpoint, the US administration was still asserting that for CVD purposes a benefit to the exporter could result not from direct financial contributions but, for instance, from export restraints that cause a discernible decrease in domestic input costs. In turn, the preamble to the 1998 final Regulations did not state the Department of Commerce's approach to this question, but made express reference to the SAA.

As reported in chapter IV, in "US – Export Restraints" the WTO panel denied that export restraints could be a cause of subsidisation.[7] However, the panel, quite leniently, concluded that the SAA does not require the DOC to treat export restraints as subsidising measures. On the contrary, in the panel's opinion, the SAA could even be read as preventing the administering authority from considering export restraint measures as a form of subsidisation because in other passages the Statement "indicates that the Administration's past practice will be pursued in future only to the extent that there is no inconsistency with the definition of subsidy under the URAA". It argued, therefore, that since Section 771(5)(B)(iii)[8] prescribes a new condition, including entrustment or direction to a

[5] Statement of Administrative Action, p. 926.
[6] Final Affirmative Countervailing Duty Determination: Certain Softwood Lumber Products from Canada. ( C-122-816) 57 FR 22570. May 28,1992. web.lexis-nexis.com/professional/
Final Affirmative Countervailing Duty Determination and Countervailing Duty Order: Leather from Argentina ( C 357-803) 55 FR 4021, October 2, 1990. web.lexis-nexis.com/professional/.
[7] See Chapter IV, p.127.
[8] 19 USCA § 1677 (5) (B) (iii)

private entity to make a financial contribution, it is clear that the practice followed in the past cannot continue without modification".[9]

The panel's argument is rather strained. Arguably, in general terms, the SAA does not compel Commerce to treat export restraints as subsidies, requiring, instead, a case-by-case analysis. This, however, does not imply that according to the SAA the inclusion of export restraints among subsidy programmes is to be viewed as past practice inconsistent with the URAA. Certainly, such inclusion would be inconsistent with the SCMA, as correctly stated by the panel.[10] But the main authoritative interpretation of the URAA is the Statement of Administrative Action itself and, as noted above, the SAA clearly suggests that the measures in question could result in some form of subsidisation. Indeed, it is rather incomprehensible that the SAA, after going to great lengths to argue that "Article 1.1(a)(1)(iv) of the SCM Agreement and section 771(5)(B)(iii) encompass indirect subsidy practices like those which the DOC countervailed in the past", quoting the mentioned investigations as an example, could draw the conclusion, as maintained by the panel, that this is not the case for practices such as export restraints. However, it is likely that the SAA interpretation will never be put to the test. The panel entertained the Canadian complaint not with reference to specific measures but to general US rules, and as the report held that these potential US CVD practices would be inconsistent with the SCM Agreement, the United States will prudently abstain from following them if the need arise, whatever the implication of the SAA language.

Section 771 (5)(E)[11] provides that a benefit shall normally be treated as conferred where there is a benefit to the recipient, and follows the pattern of Art.

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[9] United States – Measures Treating Export Restraints as Subsidy.Report of the Panel ( 29.6.2001). WT DS194, para.8.104.
[10] Ibid., paras. 8.28-8.44.
[11] 19 USCA § 1677 (5) (E)

14 of the SCM Agreement with regard to cases of equity infusion, loans, loan guarantees and provision of goods and services. The SAA remarks that the SCM Agreement does not provide a definition of benefit but Article 14 of the Agreement sets guidelines for methods used to calculate benefits, which, the statement does not fail to point out, "follow the benefit to the recipient methodology used in US CVD proceedings". Section 351.503 of the 1998 final countervailing duty regulations brings the statutory text to its logical conclusion by providing that, except when specific rules apply, the Department of Commerce will normally consider a benefit to be conferred when a firm pays less for its inputs (e.g. money, goods or services) than it otherwise would pay in the absence of the government programme, or receives more revenues than it otherwise would

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Section 771 (5)( C ) of the 1930 Tariff Act, as amended,[12] settles the controversy over the function and nature of countervailing duties, about which American scholars have long debated, by providing that the administering authority is not requested to consider the effect of the subsidy.[13] The statement is developed by section 351.503 of the 1998 regulations, which specifically states that the determination of whether a benefit has been conferred is completely separate from the examination of the effect of the subsidy. What is relevant is the assessment of the existence and amount of a benefit for the recipient, that is, whether costs have been reduced or revenue enhanced. Thus, as explained in the preamble to the regulations, if a foreign government establishes new environmental restrictions requiring firms to purchase new equipments and at the same time provides them with a grant, that grant will be countervailable for its total amount, even though it does not entirely offset the additional cost imposed

[12] 19 USCA § 1677 (5) (C)

[13] See Chapter I, section 2, p. 28.

by the environmental rules.[14] Likewise, if a subsidy causes a firm to pay higher income tax the countervailable amount is still the whole subsidy, even if the heavier tax burden reduces its impact on the firm's income and cash flow. On the other hand, it is arguable that even if the financial benefit received by the firm allows it to buy some equipment that enhances its productivity and, thus, its revenue for a multiple of the initial benefit, it is still the latter that establishes the amount of countervailing duties.[15]

**3)Financial contribution.**

The same link with administrative practice and case law prior to the Uruguay Round Agreement characterises the regulation of the various hypotheses of financial contribution.

*Equity infusion*

The current US regime on equity infusion mostly tracks the regime prior to the URAA, though with some important modifications. The latter, however, do not stem from exogenous rules, that is, from the WTO Agreement on Subsidies and Countervailing Measures, but are the result of the overhaul of its past practice conducted by the administering authority also in the light of certain decisions of the Court of International Trade (CIT) concerning particular aspects of the relationship between government-provided equity infusion and subsidisation.

Section 771 (5)(E) (i) of the Tariff Act of 1930[16], in accordance with SCMA Art 14 provides that a countervailable benefit is conferred if the investment decision is inconsistent with the usual investment practice of private investors, including the practice regarding the provision of risk capital in the

[14] Countervailing Duties: Final Rule, p.65361.
[15] See Chapter I, section 2, note 32.
[16] 19 USCA § 1677 (5) (E)(i)

country in which the equity infusion is carried out.[17] However the Tariff Act, along with the SCMA, does not shed light on the criteria the private investor would follow in deciding whether to provide new capital.

Section 351.507 of the 1998 regulations in providing these criteria relies on past administrative practice and in particular on the methodology adopted in the General Issues Appendix to the 1993 "certain steel products from Austria" affirmative determination.[18] Thus, as noted in chapter III, the methodology currently followed by the Department is divided along two lines according to the availability of private investors' prices. In the affirmative case the Department of Commerce would consider the equity infusion as conferring a benefit if the price paid by the government is higher than the price paid by private investors for the same new issue.[19] The amount of the subsidy is, therefore, produced by the difference between the two prices. In appropriate circumstances shares with similar characteristics may be compared, provided that appropriate adjustments are made.[20] The practice in question was upheld by the CIT in Geneva Steel v. United States.[21] In this case two government-owned Belgian companies, Cockerill and Clabecq, had converted some of their "conditional and convertible participating bonds" into "parts beneficiaries", which were bought by the government. Both instruments fell within the category of "hybrid securities", so-called because they appear to be neither debt nor equity. Parts beneficiaries, however, prevalently presented similar features to shares and, therefore were equated to equities. On the other hand, they were not traded on the Belgian market. The Court agreed with the method used by Commerce to measure the

[17] Chapter IV, p. 156 et seq..
[18] Final Affirmative Countervailing Duty Determination: Certain Steel Products from Austria. 58 FR 37217, 37244. July 9, 1993..web.lexis-nexis.com/professional.
[19] Sec. 351.507, para. (a).(2)
[20] Sec. 351.507, para. (a) (2) (iv). ..
[21] Geneva Steel v. United States. 20 CIT 7, 914 F.Supp. 563 (1996). web.lexis-nexis.com/professional

benefit, which calculated the premium paid by the Belgian government as the difference between the price paid for the "parts beneficiaries" and the common shares of the two companies quoted in the market, although the former had only some of the characteristics of the latter. The Court held that if the marketplace is the "ultimate arbiter" of economic valuation, then Commerce's preference to look to market-determined prices before resorting to its equityworthiness inquiry, viewed as a "reasonable surrogate" for valuation, is a proper exercise of its discretion.

In the absence of a benchmark market price, the Department of Commerce since the early 1980s has focused on the equityworthiness of the firm receiving the capital infusion and concentrates on its ability to generate a reasonable rate of return within a reasonable amount of time when the investment capital is provided. The reasonable rate of return must be assessed in real terms, that is, taking into account the effects of inflation. Thus, in "Steel wire rod from Venezuela" Commerce, which in the preliminary decision held that the conversion of the Venezuelan company' s external debt into equity was not countervailable because the firm showed a sufficient return rate on capital, in its final decision considered such conversion as countervailable. Commerce argued that, although the company had engaged in a rationalisation process after the capital infusion, during the period of investigation it had a negative return on equity when adjusted for inflation and, therefore, could not have attracted capital from private investors.[22]

As noted in Chapter III, the US approach is not exempt from the criticism that it is too narrowly focused on the firm's ability to provide profits. In "steel wire rod from Venezuela" the respondent argued that an inside investor might

[22] Final Affirmative Countervailing Duty Determination: Steel Wire Rod from Venezuela. 62FR55014,55020. October,20,1997. www.ia.ita.doc.gov/frn/frnoct97/c307814a.htm

have made the investment in spite of the negative return. The Department rejoined that it had never distinguished between "inside" and "outside" investors, as "it would be inappropriate, if not impossible, to fashion a unique inside investor standard as a variation of the Department's reasonable private investor". This argument reflects the approach used by the administering authority in "Certain steel products from Austria". In that case the respondent maintained that, in certain situations, an inside investor's decision to invest may reasonably reflect a desire to reduce or forestall an expected loss rather than to increase income, arguing that the effect of the investment could be to reduce the losses by an amount greater than the amount of the investment or the need to save the firm from insolvency and its costs. It also submitted that the inside investor is more advantageously situated than the outside investor because the former is likely to have access to better information concerning the firm's investment plans, the firm's past problems and the measures taken to correct them. The Department, following the viewpoint already held in previous cases, stated that for a rational investor the decision to invest is only dependent on the marginal return expected from each additional equity infusion. Thus, regardless of whether the investor is or is not an inside investor, the investment should only be made if the present value of the expected return is greater than the return from alternative investments.[23]

It is submitted that this argument is narrowly focused on a particular category of investors. Certainly, the provision of risk capital just with the aim of avoiding employee layoffs or to maintain employment levels or social services in a disadvantaged area can be accused of contradicting economic logic. But other factors directed at reducing losses or maintaining the economic presence of a

[23] 58 FR 37217, 37249.July 9, 1993.web.lexis-nexis.com.professional

group of companies in a trade area would be perfectly acceptable, from the economic viewpoint, if taken into consideration by private firms in their investment decisions.

Besides, even if this approach were consistent with previous US legislation, it is doubtful that it is consistent with the URAA reform and with the Agreement on Subsidies and Countervailing Measures. Indeed, SCMA art. 14, reproduced in section 771 (E) (i) of the 1930 Tariff Act, as amended, makes reference to the "investment practices in the territory" of the WTO members, thus implying that a multiplicity of patterns can be applied in assessing the consistency with the usual investment practices of private investors.[24]

The methodology applied by the Department in assessing the amount of the benefit once its existence has been ascertained is also subject to contention.

If a company is found unequityworthy, DOC considers the whole amount of the equity infusion as countervailable subsidy, equating it to a grant. This practice was upheld by the Court of International Trade in British Steel plc v. United States[25]. Actually, as reported in the preamble of the 1998 regulations, the 1997 proposed regulations changed the criterion, adopting a "constructed private investor price (CPIP)", that is, the price that a reasonable private investor would be willing to pay for the company's shares. Subsidy would be reckoned by the difference between the government purchase price and the CPIP.[26] The proposed reform, however, was abandoned because of the strong criticisms of many American commentators, also in light of the British Steel decision. The approach of the Department of Commerce, now codified by section 351.507, para. (a) (6) of the 1998 regulations, posits that the comparison is between what the company has

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[24] 19 USCA § 1677 (5) (E)(i)

[25] British Steel plc v. United States, 19 CIT 176;879 F.Supp. 1254 (1995).web.lexis-nexis.com/professional p.244.

[26] www ia.ita.doc.gov regs/98_30565.text..p.65374.

actually received and what it would have received without government intervention, which in the opinion of the Department, is zero. Such an assumption, however, is questionable. Indeed, nothing prevents a private investor from acquiring shares in a company, unequityworthy as it may be, as long as their purchase price is low enough to allow a capital gain when re-sold on the secondary market. It is, therefore, arguable that the less strict method proposed by DOC in 1997 would provide a more reasonable and, thus, equitable, way to assess the benefit.

The bias of the current approach is also proved by contrasting it with the method applied to equityworthy companies. In keeping with the treatment of unequityworthy firms, Commerce for a long time deemed that the provision of risk capital to an equityworthy company did not confer a benefit. However, in AIMCOR II the Court of International Trade ruled that because of restrictions imposed on the shares bought by the government, the purchase of the shares was inconsistent with commercial considerations, although the firm under investigation was equityworthy.[27] Thus, sec. 351.507, para.(a)(5) now provides for further analysis to determine whether the purchase of equities in general by the government have special conditions which render the investment inconsistent with usual private investment practices. If so the administering authority is required to assess the benefit on a case-by-case basis.

*Loans*

Section 771 (5) (E) (ii) of the Tariff Act of 1930, as amended[28], requires the administering authority to use a comparable commercial loan as a benchmark

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[27] AIMCOR Alabama Silicon Incrporation v. United States, 19CIT 1497; 912F.Supp. 549 ( 1995) web.lexis-nexis.com professional.

[28] 19 USCA § 1677 (5) (E)(ii)

in determining whether a government-provided loan confers a benefit or not. The section, thus, reproduces SCMA art. 14, which, in turn, adopted the American pattern to assess the benefit: the difference between what the borrower actually pays and the cost of a comparable commercial loan on the market, even though the cost for the government in providing funds is zero.[29]

Section 351.505, para. (a) (1) of the 1998 regulations confirms Commerce's practice of normally comparing effective interest rates rather than nominal rates. The former provide the actual cost of the loan, including the amount of any fee, commission and government charge in addition to the nominal rate. Only if effective rates are not available will the Department resort to nominal rates. Thus, in "Stainless steel plate in coils from Italy" the Department added the amount of fees, commissions and other expenses to the ABI (Italian Banking Association) rate used as a benchmark, as the latter did not include such additional costs.[30]

The commercial loan must be comparable. The administering authority will place primary emphasis on similarities in the structure of the loan (e.g., fixed interest rate v. variable interest rate), the maturity of the loan (e.g., short term v. long term) and the currency.[31] This approach is elucidated by the "Cut to length carbon steel plate from Belgium" administrative review.[32] In this case a Belgian company had received, among others, a long-term loan from the Societé Nationale de Credit à l'Industrie, which the Department had not considered countervailable in the preliminary results, on the basis of a comparison with the average interest rates charged by another Belgian bank, Kreditbank, specialising in industrial

[29] In particular, Chapter IV, p.123.
[30] Final Affirmative Countervailing Duty Determination:Stainless Steel Plate in Coils from Italy, 64FR15508,15511 (March 31,1999) www.ia.ita.doc.gov/frn/9903frn/99-331h.txt
[31] Sec. 351.501 (a) (2).
[32]. Final Results of Countervailing Duty Administrative Review: Cut to Length Carbon Steel Plate from Belgium. 64 FR 12982,12986 (March 16, 1999) http://www.ia.ita.doc.gov/frn/9903frn/99-316g.txt

credits. The petitioners argued that other benchmark rates should be used because throughout the period of investigation, the interests charged by Kreditbank had not kept pace with the rise of the Belgian prime interest rate reported by the International Monetary Fund (IMF), which represented the maximum rate charged by deposit banks to prime borrowers. The petitioners contended, therefore, that other interest rates should be used as a benchmark, in particular either the IMF rates or the LIBOR, applying on them a spread to equalise them to long-term rates. Commerce held that that IMF rates (and even more so the LIBOR) should not be used because they do not reflect market rates on long-term lending. In the absence of comparable commercial loans taken out by the company under investigation a national average long-term rate should be used. In this case the Kreditbank interest rate corresponded to national average interest rates in Belgian currency.

The 1998 regulations have amended the previous practice with regard to the selection of the benchmark. Whereas in the period prior to the 1998 Regulations, Commerce initially used national average interest rates to determine the benefit from government-provided loans, for both short-term and long-term loans, nowadays Commerce would normally use national averages only in the event that the firm did not take out any commercial loan during the period of investigation or if such loans were not comparable. For instance, in "Stainless steel bar from Italy" Commerce rejected the request of one of the Italian companies under investigation, Valbruna, to use as a long-term benchmark rate the interest rate it paid on three-month loans which it renewed at the end of every quarter. Valbruna suggested that large Italian companies preferred loans with three-month EURIBOR rates rather than with ABI (Italian Banking Association) prime rates because they allowed companies to borrow money in Italian lire or

Euros at an effective rate below the ABI prime rate. Commerce held that the three-month EURIBOR rate should be viewed as a non-comparable short-term interest rate. The fact that the quarterly loans were periodically rolled over was not a sufficient reason to treat them as a substitute for an actual long-term loan.[33]

As in the past, particular rules apply to so-called uncreditworthy companies. The distinction between creditworthy and uncreditworthy companies applies only to long-term loans as, according to Commerce, short-term loans do not present default problems that warrant a specific methodology. The US methodology is based on the notion that, when a commercial lender makes a loan to a company considered uncreditworthy, there is a higher probability that the borrower may default and consequently the lender will charge a higher interest rate than that applied to creditworthy firms. Section 351.505 (a) (4) provides that a company is held uncreditworthy if information available at the time the terms of the government-provided loan were agreed upon indicates that the firm could not have obtained long-term financing from commercial sources, which encompass bank loans and the issue of non-speculative bonds. In the investigation the administering authority looks in particular at the financial situation of the company, focusing on the following factors: receipt of comparable commercial long-term loans; present and past financial health as reflected by various financial indicators; past and present capacity to meet costs and fixed financial obligations with cash flow; evidence of future financial conditions provided by market studies, project and loan appraisal, and country and industry economic expectations.

A detailed example of the methodology used by Commerce is provided by "Certain steel products from Brazil". The Department considered the

[33] Preliminary Affirmative Countervailing Duty Determination and Alignment of Final Countervailing Duty Determination with Final Antidumping Duty Determination: Stainless Steel Bar from Italy. 66 FR 30414, 30418 June 6, 2001, www.ia.ita.doc.gov/frn/0106frn/.

companies under investigation, COSIPA and CSN, uncreditworthy. In particular the investigation showed that although the former company had posted a yearly profit it soon reverted to a pattern of increasing losses and the latter after two years of losses had recovered to post a small profit. The relevant factor for both companies was their supposed inability to promptly meet their current liabilities with their assets, borne out by deteriorating current and quick ratios.[34]

An innovation introduced by the 1998 regulations is the extension of the creditworthiness concept, till then exclusively focused on the company, to individual projects.[35] The Regulations now recognise that, though the firm that takes out the loan can be creditworthy, there are situations where the risk associated with a new project may be much higher than the average risk of the company's existing operations. In such cases the creditworthy analysis cannot be limited to the company, but can focus on the reliability of the project and its ability to repay the loan.

*Taxes*

The Tariff Act and the SAA do not shed great light on the treatment of either direct or indirect taxation for countervailing purposes, which, however, is an issue on which US practice and legislation has for long focused its attention. The task of filling the gap is met by the 1998 regulations.

With regard to direct taxes section 351.509, codifying previous practice provides that a benefit exists to the extent that the tax paid by the firms as a result of the tax programme is less than the tax it would have paid in the absence of the programme. This can result either from partial exemption or remission of tax due

[34] Preliminary Affirmative Countervailing Duty Determination and Alignment of Final Countervailing Duty Determination with Final Antidumping Duty Determination: Certain Hot-Rolled Flat-Rolled Carbon Quality Steel Product from Brazil. 64FR8313, 8319, February 19, 1999. www.ia.ita.doc.gov frn 9902frn/99-219b.txt.
[35] Sec. 351.505 (a) (4).

or from a reduction in the income base used to assess the tax amount. Thus, in "Stainless steel plate in coils from Belgium", where a Belgian company had been allowed under a regional programme to claim accelerated depreciation for investments located in a disadvantaged area, the DOC considered the tax saving, which resulted from a reduction in the tax base of the company, as tax exemption, rather than tax deferral, as it was uncertain that the benefits of the accelerated depreciation programme would be offset by higher taxes in the future.[36] Likewise, in "Certain pasta from Italy" Commerce countervailed the exemption from the Italian Local Revenue Tax (ILOR) granted for a period of ten years to companies located in disadvantaged regions on profits derived from new plants and equipments or from plant expansion and improvement.[37]

On the other hand, the deferral of taxes is deemed to produce a benefit only to the extent that appropriate interest charges are not collected. In such a case the deferral is treated as a government-provided loan to the amount of the tax deferral.[38]

As a general rule the exemption or remission upon export of indirect taxes gives rise, under section 351.517, to a benefit to the extent that the amount remitted or exempted exceeds the amount levied with respect to the production and distribution of like products sold for domestic consumption. In accordance with Annex II to the SCMA, special rules apply under the following section to the exemption, remission or deferral of prior stage cumulative indirect taxes, that is, taxes levied at any stage of production and distribution without any set-off for

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[36] Final Affirmative Countervailing Duty Determination Steel Plate in Coils from Belgium 64FR15567, 15580, March 31, 1999. www.ia.ita.doc.gov/frn/9903frn/99-331g.txt.
[37] Final Affirmative Countervailing Duty Determination: Certain Pasta from Italy. 62FR30287,30298. June 14,1996. www.ia.ita.doc.gov/frn/frnjun96/c475819.html
[38] Sec. 351.509 (a) (2).

prior stage taxes.[39] Value Added Tax (VAT) is, therefore, excluded from this tax group.

As noted by Stanbrook and Bentley with reference to the EU regime, the cumulative tax system favours those producers that have a fully integrated production chain as against those whose production is divided into many stages.[40] To reduce such discrimination, exemption or reimbursement is allowed in order to compensate for multi-stage taxation. One problem, however, results from the lack of transparency inherent to the system, which could entail a more favourable treatment for export sales. Under section 351.518, a countervailable benefit exists to the extent that the exemption or remission of prior stage cumulative taxes extends to inputs that are not consumed in the production of the exported product, making allowance for waste. There is, however, a snag for the exporter as the section also provides that if the government of the exporting country has not in place or does not apply a procedure to confirm which inputs are consumed in the production of the exported product or, if in the opinion of the administering authority, the system in place is not reasonable or is not applied effectively, then the entire amount of the exemption, remission, or even deferral is considered to confer a benefit.[41]

*Provision of goods and services*

In accordance with the SCMA text, section 771 (5)(E)(iv)[42] provides that a subsidy exists when goods and services are provided by an authority in the exporting country for less than adequate remuneration, the latter being determined

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[39] See Chapter II, p.54.
[40] Clive Stanbrook and Philip Bentley, *Dumping and subsidies: the law and procedure governing the imposition of antidumping and countervailing duties in the European Community* (London:Kluwer Law International, 1996) p. 92.
[41] Sec.351.518 (a)(4).
[42] 19 USCA § 1677 (5) (E)(iv)

"in relation to prevailing market conditions in the country which is subject to investigation or review".[43] The Act itself does not give any express answer to the following questions:

1) What if the public authorities influence the behaviour of the market in the country under investigation?

2) What if the public authority is the only supplier of the goods or services in question?

In keeping with the US traditional market-oriented philosophy, the 1998 regulations stress that the adequate remuneration benchmark must be based on prices that have not been distorted by government involvement in the market. The statutory term "prevailing market condition" is, therefore, interpreted as market-determined price, which, in turn, is, normally, viewed as the result of competition among private firms. Section 351.511 has adopted a hierarchical approach, according to the availability of such a benchmark. In the affirmative case, the administering authority relies on the comparison between government prices and market-determined prices stemming from transactions within the exporting country. The market-determined price can also include actual sales from government-run competitive bidding, open to everybody and based solely on price. In such a case, according to Commerce, even if the involvement of public bodies can have some impact on the prices of the goods or services, the distortion will normally be minimal. Apart from this strictly confined hypothesis, the presence of public entities is viewed as market distorting.

If, consequently, there are no usable domestic market-determined prices, Commerce will turn to world market prices available to purchasers in the country under investigation.[44] Commerce's reasoning and its way of proceeding are

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[43] Chapter IV,p.157.

[44] Sec. 351.511 (a)(2)(iii).

illustrated by the investigation concerning exports of softwood timber from Canada, harvested at allegedly lower prices than adequate remuneration for government and local authorities, which was the subject of a case decided by the WTO Dispute Settlement Body in 2004.[45] The administering authority held that the point of comparison for measuring the benefit from these types of subsidies is the marketplace free from government interference. It pointed out, in the first place, that this is the benchmark established by both the US statute and the Subsidies Agreement for government-provided loans, loan guarantees and capital infusions, which refer to the "commercial loans that can actually be obtained on the market,", to "comparable commercial loans if there were no guarantee by the authority" and to the ``usual investment practice of private investors,". The Department also noted that the US statute requires that the analysis be made "in relation to prevailing market conditions in the country under investigation", and not simply "in the country under investigation", thus excluding a comparison based on whatever the condition of the exporting market might be. Commerce found further support for its opinion in the "chapeaus" of section 771(5)(E)[46] and article 14 of the Subsidies Agreement which refer to benefit for the recipient. In the Department's opinion such reference implies that the true measure of the benefit derived from any government largesse is by reference to what the recipient would have had to pay for the physical or financial goods or services in the marketplace without any government involvement.

Proceeding to the assessment of the Canadian softwood market, Commerce noted that a large government presence in the market tends to make much smaller private suppliers price-takers since the government-dominated

[45] Notice of Preliminary Countervailing Duty Determination, Preliminary Affirmative Critical Circumstances Determination and Alignment of Final Countervailing Duty Determination with Antidumping Duty Determination: Certain Softwood Lumber Products from Canada. 66FR43186, 43193, August 17,2001.www.ia.ita.doc.gov/frn/0108frn/01-20674.txt.

[46] 19 USCA § 1677 (5) (E)

market distorts the market as a whole if the government does not sell at market-determined prices. Because of provincial governmental control of the market through a system of administratively-set prices and other market distorting measures, there was no market-determined price for stumpage within Canada that was independent of the distortion caused by the governmental interference in the market.[47]

Having discarded private market prices in Canada as a suitable benchmark to assess the benefit, the Department relied on the world market, provided its conditions also applied to Canadian consumers. It consequently held that stumpage prices from the United States qualified as commercially available world market prices because U.S. lumber would be available to softwood lumber producers in Canada at the same prices available to U.S. lumber producers and because stumpage in the United States along the northern border was comparable to Canadian stumpage.

The third hypothesis covered by the Regulations concerns the lack of alternative sources of supply for consumers in the country under investigation. In this case Commerce inquires whether the monopolistic public supplier fixes its offer price in accordance with market principles. In "Steel wire rod from Trinidad and Tobago" the Department held that the provision of gas by the National Gas Company (NGC), the sole supplier of natural gas to industrial and commercial users in the islands, did not grant a subsidy because the NGC had established a price policy that was able to entirely cover its production costs and to provide an

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[47] As the reasoning of the affirmative determination was partially upheld by the WTO Appellate Body in its January 204 report, we refer to our remarks in Chapter VII, section 1.

adequate return on its sales.[48] This methodology was later codified in the 1998 regulations.[49]

**4) Specificity**

Section 771 (5A) of the Tariff Act[50] mirrors the provisions of article 2 of the SCM Agreement dealing with specificity, which, in turn, as the SAA is eager to point out, reflects US practice.[51] The Statement of Administrative Action stresses the intention of the Administration to apply the specificity test "as an initial screening mechanism to winnow out only those foreign subsidies which truly are broadly available and widely used throughout an economy".[52]

As with the SCMA, export and import substitution practices are deemed to be specific. Likewise, section 771(5A) (D)[53] distinguishes between "de iure" specificity and "de facto" specificity. The verification of the latter rests on four factors:

1) number of enterprises, industries or groups thereof which actually enjoy a subsidy;

2) predominant use of a subsidy by an enterprise, industry or group of industries;

3) receipt of disproportionately large amounts of a subsidy by an enterprise, industry or group;

4) the manner in which the authority providing a subsidy has exercised discretion in its decision.

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[48] Final Affirmative Countervailing Duty Determination: Steel Wire Rod from Trinidad and Tobago, 62FR55004, 55009, October 22, 1997,www.ia.ita.doc.gov/frn/frnoct97/c274803a.htm.
[49] Sect. 351.511 (a)(2)(iii).
[50] 19 USCA § 1677 (5 A)
[51] SAA, p. 929.
See Chapter IV, section 2 – *3) Specificity*
[52] SAA, p. 930.
[53] 19 USCA § 1677 (5A)(D)

The SAA points out that section 771(5A)(D)(iv) of the Tariff Act[54] "corresponds to SCMA Article 2.2, while codifying Commerce's current specificity test[55]". Under this test, subsidies granted by a state or province that are not limited to a specific enterprise, industry or group of industries are not considered specific, whereas subsidies provided by central governments to particular regions, including states or provinces, are considered specific regardless of availability or use within that region.

It is clear that this approach favours federal governments. The bias, arguably, was particularly evident with regard to the treatment of subsidies granted to promote the development of disadvantaged regions during the short period preceding the expiry of such provision. It is submitted that the US Administration was often able to implement the provisions of the SCMA concerning green light subsidies in too strict a way so as to limit as much as possible the alignment of its regime to measures that in many cases were not considered in line with the US economic outlook. The Statement of Administrative Action begins by pointing out that "in some instances the terms and conditions for determining whether the subsidy is non-countervailable are expressed ambiguously" and, therefore, "the Administration believes that certain terms and conditions require clarification". As regards disadvantaged regions the SAA states "the green light provision governing assistance for disadvantaged regions must be strictly construed in order to prevent the circumvention of the intent of the provision".

The first victims of the strict US approach were a set of Italian programmes under law 64/86 for the promotion of growth in the so-called "Mezzogiorno" (Southern Italy). The first investigation of this kind, conducted

[54] 19 USCA § 1677 (5A)(D)(iv)
[55] SAA, p. 932.

in 1995, concluded that the information submitted by the government of Italy did not support the claim that the programmes qualified as non-countervailable subsidies because, while section 771(5B)(C) of the Tariff Act[56] requires that regional subsidy programmes be part of a generally applicable regional development policy, law 64 provided benefits solely to the South of Italy . Besides, contrary to the provision of the Tariff Act, no information had been provided to indicate that law 64 or its implementing regulations met the neutral and objective criteria, based on per capita income or unemployment, set out by the SCM Agreement and the US statute. On the other hand, since the "Mezzogiorno" was a specific area, the measures were specific.[57]

It must be acknowledged that the troubles of law 64/86 programmes were mostly self-inflicted pains. It is likely that the Italian lawmakers in drafting the law and the Italian executive in implementing it, unaware of impending multilateral obligations, took it as granted that the reality of a backward "Mezzogiorno" was internationally acknowledged. Yet, the economic problems of Southern Italy, both in terms of per capita income and unemployment, had been the subject of conspicuous economics literature and were real and well known. It must also be recognised that the law in question had problems with the European Communities too, since, apparently, the law had pushed the economic boundaries of the region northwards, including provinces whose level of economic development approached the Italian average, and some of the companies under investigation were located there.

However, law 64/86 was replaced by law 488/92. The latter, which provided grants for industrial projects in depressed regions all over Italy and not only in the "Mezzogiorno", had been cleared by the European Commission.

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[56] 19 USCA § 1677 (5B)©

[57] Preliminary Affirmative Countervailing Duty Determination:Certain Pasta from Italy. 60FR53739, 53742, October 18, 1995, www.ia.ita.doc.gov/frn/frnoct95/c475819.001

Besides, the funds used to pay benefits under the law derived in part from the Italian government and in part from the Structural Funds of the European Union, and to be eligible for benefits under the measure in question the enterprise had to be located in one of the regions in Italy identified as EU Structural Funds objective 1(underdeveloped regions), 2(areas in industrial decline) or 5 (regions with very low populations). It is, thus arguable that, at least with reference to the European Community regime, the law in question provided neutral and objective criteria for assessing whether a region is or is not disadvantaged. It is also arguable that at least some of its benchmarks actually coincided with those provided by the SCMA and reproduced verbatim by the Tariff Act as amended. Yet, this measure too was hastily considered countervailable within the meaning of section 771(5) of the Act[58]: as the assistance was limited to enterprises located in certain regions, the US administering authority determined that the programmes under law 488/92 were specific.[59]

**5) Allocation of benefit over time.**

Section 351.524 of the 1998 countervailing duty regulations codifies the solution to a problem that had confronted Commerce for a long time before the URAA - the allocation of benefit over time.[60] Governments often grant subsidies to allow companies to build plants or to acquire other forms of capital equipment. In other cases the subsidy is provided to offset losses or to strengthen the financial structure of the company through capital infusion. If the benefit were allocated over the value of the company's production in a single year, the subsidisation rate

[58] 19 USCA § 1677 (5)
[59] Preliminary Results of the Second Countervailing Duty Administrative Review Certain Pasta From Italy,64FR 17618,17620, April 12,1999.www.ia.ita.doc.gov/frn/9904frn/99-412a.txt Stainless Steel Plate in Coils from Italy, 64FR15508,15515 March 31, 1999, www.ia.ita.doc.gov/frn/9903frn/99-331h.txt
[60] For an overview of Commerce's methodologies prior to the URAA see John S. Sciortino, "Calculating Subsidy Values in Countervailing Duty Cases: The Use of the present Value Methodology", in John H. Jackson et al., eds, *International Trade*, op.cit.p.8-7 et seq.

for that year would be particularly high, while in the years following there would be no trace of the subsidy.

A distinction must be made between the moment in which a firm is considered as having received a subsidy and the allocation of the benefit to a particular time period. For instance, in the case of a grant the subsidy is considered received on the date at which the firm receives the grant. Likewise, in the case of a debt or interest assumption or forgiveness the benefit is considered received as of the date in which the debt or interest is assumed or forgiven. However, according to the nature and destination of the subsidy the benefit must be allocated to a particular time period, which often is not restricted to the moment of bestowal but can span many years. GATT 1994 and the SCMA do not address allocation over time. Yet, since the benefit is a fundamental element of subsidy, proper allocation of benefit is a pre-requisite for ascertaining both the existence of subsidisation and the correct assessment of its amount. Art. VI:3 of GATT 1994 provides that no countervailing duty "shall be levied ... in excess of an amount equal to the estimated bounty or subsidy determined to have been granted" and the subsidy is determined with reference to a specific period of investigation (POI).[61]

The US statute is silent on this issue. It was the administering authority that over twenty years developed several methodologies to determine whether a subsidy should be considered "recurring" or "non-recurring" and to assess its value in each year of the POI.

The regulations issued by Commerce in 1998 modified the approach that was first developed in the General Issue Appendix to "certain steel products from Austria", according to which the Department would consider a benefit as non-

[61] The question of allocation of the benefit over time can also be appreciated with regard to the case of change in ownership of the subsidised company, as shown in the following chapter.

recurring if it is exceptional, that is, non-recurrent on a regular or predictable basis, or requires government approval.[62] According to section 351.524, in addition to examining whether the subsidy is exceptional or requires government approval, the administering authority shall also examine whether the subsidy was provided for, or tied up to the capital structure or capital assets of the firm.[63] Capital assets are defined as plants and equipment used to produce other goods. Capital structure is the combination of common equity, preferred stock and long-term debt. The 1998 regulations add a non-binding list of subsidies which are normally treated as providing non-recurring benefits and subsidies treated as providing recurring benefits. Among the former are direct tax exemptions and deductions, provision of goods and services for less than adequate remuneration; export promotion assistance; and worker assistance and training. Among the latter we find equity infusions, grants, plant closure assistance, debt forgiveness, coverage for operating loses, debt-to-equity conversion, provision of plants and equipment. [64]

Commerce has not abandoned the long-established pattern of allocating a benefit over the average useful life (AUL) of the firm's physical assets as set forth in the Internal Revenue Service (IRS) Class Life asset Depreciation Range System.[65] In other words, the benefit is allocated according to the period of amortization allowed for fiscal purposes by the IRS.[66] Thus, the physical assets'

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[62] Final Affirmative Countervailing Duty Determination: Certain Steel Products from Austria. 58 FR 37217, 37226 ,July 9, 1993.web.lexis-nexis.com/professional

[63] Sec. 351.524 ( c ) (2).

[64] Sec.351.524 (c )(1).

[65] Sec.351.524 (d) (2).

[66] In implementing the Average Useful Life criterion the US administering authority (as explained in details in the Doha Round – Negotiating Group on Rules, "Allocation of Subsidy Benefits over Time" Communication from the United States. TN/RL/W/148 – 22 April 2004) assumes that the benefit is declining over time and that, therefore, the subsidy recepient receives greater benefit in the early years of the useful life of the asset, according to the following formula:

$$\frac{A_k = y/n + [y - (y/n)(k - 1)]d}{1 + d}$$

useful life is normally determined with reference to the US industrial structure even though the assets of the firm under investigation may be located in a very different productive environment.

This methodology does not seem to be very consistent with the opinion of the Court of International Trade according to which in determining the AUL the administering authority should follow a company specific approach.[67] Indeed, the US Executive has adopted a compromise solution which, however, casts the burden of proof on those that do not consider the AUL established by the US IRS as a proper assessment of the real useful life of a company's assets. To be allowed to use a company specific AUL, the firm must base its depreciation on an estimate of the actual useful life of the assets and must use straight-line depreciation, or demonstrate that its calculation is not distorted by irregular or uneven additions to the pool of fixed assets.[68] Also a country-wide AUL for the industry under investigation could be accepted by the US administering authority if the respondent government demonstrates that it has a system to calculate AULs and if that system provides a reliable representation of the average life of the assets concerned. [69] Even if these proofs are given – certainly not an easy task – Commerce can continue to apply the IRS tables AUL if the company specific AUL or the country-wide industry AUL differs from the former by less than one year.[70]

A possible flaw in the US methodology is the exclusive link it establishes between the allocation of non-recurring subsidies, on the one hand, and the average useful life of the company's assets, on the other. In short, the US

Where $A_k$ is the amount countervailed in year K; Y is the face value of the grant; n is the average useful life of the assets in the industry being investigated; d is the discount rate; and K is the year of allocation.

[67] British Steel PLC v. United States, 19 C.I.T. 176; 879 F. Supp. 1254, (1995).

[68] Sec.351.524 (d)(2)(iii).

[69] Sec.351.524 (d)(2)(iii).

[70] Sec.351.54 (d) (2)(iv).

method posits that the life of the assets closely approximates the duration of the benefit. This is logical when the grant is used for plant and equipment purchase, or other forms of new investments that increase the firm's capacity of production. However, the range of non-recurring benefits is much wider, encompassing hypotheses such as coverage for operating losses, debt-to-equity conversion and debt forgiveness, which in most cases do not finance future or actual fixed capital investments, but already incurred expenditures and losses originating from other operations.

The methodology, which has been upheld by the CIT, relies on the guidelines on amortization and depreciation adopted on 25 April 1985 by the Committee on Subsidies and Countervailing Measures.[71] The Committee, however, was one of those placed under the authority of the Tokyo Round Subsidies Code, and, arguably, its opinion could bind only the Parties to the 1979 Agreement. Besides, nothing indicates that the guidelines have been incorporated in the current WTO fabric. Actually, the European Union, which subscribed the Subsidies Code, has followed a more sophisticated approach drawing a line between subsidies that can be linked to the acquisition or future acquisition of fixed assets and subsidies that cannot be linked to the acquisition of depreciating assets, providing for the latter that "the amount of the benefit received during the investigative period shall in principle be attributed to this period, ...unless special circumstances arise justifying attribution over a different period".[72]

**6) Injury**

Only marginal amendments to previous law and practice have been introduced by the post URAA regime with regard to injury. The Statement of

[71] B.I.S.D 32nd Suppl. (SCM 64).
[72] Council Regulation (EC) n. 2026/97, art.7.4.

administrative Action holds that the SCM Agreement did not change the causation standard from that in the Tokyo Round Subsidies Code and that, as a consequence, the US law already implemented the Agreement provisions. In particular the SAA points out that although SCMA Articles 3.5 and 15 include new language requiring investigating authorities to examine all known factors injuring domestic industry to ensure against attributing injury from other factors to the subsidised imports, this does not imply that the investigating authority must isolate injury caused by the former factors from injury caused by the latter.[73]

The main statutory amendments concerned "de minimis" and "negligible" subsidies, cumulation and the introduction of the sunset review.[74]

In compliance with SCMA article 11.9, section 703(b)(4)(A) of the Tariff Act as amended[75] has raised the "de minimis" threshold to 1% ad valorem for developed countries. For developing countries which are members of the WTO the threshold has been raised to 2%. The Statement of Administrative practice, however, points out that the new thresholds only apply to initial CVD investigations and do not extend to administrative reviews.[76] Likewise, in keeping with the SCM Agreement, in assessing negligibility the Tariff Act as amended relies on the share of all merchandise imports into the US rather than on the US market share, as was the criterion prior to the URAA. Section 771(24)[77] provides that imports from industrial and developing countries are negligible if they account for less than 3% and 4% of total imports respectively.

To comply with art. 15.3 of the SCMA, section 771(7)(G) of the Tariff Act[78] provides that an investigation can cumulate imports that compete with other

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[73] SAA p.51.

[74] As regards the SCMA see Chapter IV,p.156.

[75] 19 USCA § 1671(b)(b)(4).

[76] SAA p.939.

[77] 19 USCA § 1677 (24).

[78] 19 USCA § 1677 (7)(G)

imports and domestic like products only where the petitions are filed, or the investigations are self-initiated, the same day. In such cases, under sect.771(24) imports are considered non-negligible if their share of total imports cumulatively exceeds 7% and 9%, respectively for industrial and developing countries.

While prior to the URAA countervailing duty orders were potentially unlimited, in line with art.21 of the SCM Agreement, section 751( c ) of the Tariff Act[79] provides for a "sunset review", under which all countervailing duties will lapse five years after the imposition, unless the administering authority determines that the expiry of the duty is likely to lead to continuation or recurrence of subsidisation and injury.

**Conclusion**

From the foregoing we can draw this morale: the secret to preserve your domestic regime in an increasingly interdependent trade environment is to secure a diplomatic victory at the multilateral table. Having withstood the uncoordinated assault of its trade partners the United States was able to impose its philosophy and methodology on the multilateral regime for countervailing measures. This having been done, only minor amendments had to be introduced into the US statute to appease trading partners, in particular developing countries - sunset review, higher "de minimis", stricter rules for cumulation.

The conclusion we can draw from the comparison between the current US CVD regime and that in force before the URAA can be summarised in one word only - "continuity". If there are changes outside the statute, they are mostly endogenous, resulting from the overhaul of past practice carried out by Commerce

[79] 19 USCA § 1675 ©.

or from some CIT decisions.. This was possible because, as noted in chapter III, the multilateral regime on countervailing measures reflects the American perspective which relies on the market as the only benchmark for assessing the existence and amount of a subsidy, rather than looking at budgetary costs, as previously argued by the European Community. The recognition of market predominance meant that no particular change was required with respect to the two pillars of the subsidy concept - benefit and financial contributions. Both revolve on the market and, according to the US uncompromising point of view, centred on the pursuit of maximum profit, coupled with minimum government presence. However, continuity with previous US rules and practices that held sway in shaping the new multilateral regime does not necessarily imply full consistency with the latter.

In particular, with regard to financial contributions, the link with past administrative practice is illustrated by the approach of Commerce to equity infusion in unequityworthy companies, where the Department, continues to focus on the expected return of the investment vis-à-vis alternative investments. It is arguable, however, that the SCMA text lends itself to a more flexible interpretation. Likewise it is arguable that US methodology which equates to a grant the whole amount of the equity infusion in unequityworthy companies could be out of keeping with the principle underlying Art. 6 of GATT 1994 and the SCM Agreement, according to which no duty can be imposed in excess of the correctly estimated subsidy. And yet, there is nothing in the Tariff Act, as amended that is in contrast with the text of the SCM Agreement, nor did the SAA foster such a strict interpretation of the US statute. The administering authority has just continued to use a methodology which pre-dates the URAA. The rather severe US approach has not been challenged until now in the WTO arena. On the contrary, as regards the provision of goods and services, the Appellate Body has endorsed the quite stringent US viewpoint on the impact of government activities on the structure of the market.

The US regime imposed its hallmark on key aspects of the third pillar of subsidy ascertainment - specificity. In particular, the SCMA enshrined the US outlook which favours federal states as regards the granting of regional subsidies. Later the United States, in keeping with the wishes of Congress, managed to exploit to the full in its countervailing duty proceedings the stringency of the multilateral rules it was able to impose on non-countervailable subsidies.

Finally, the priority attributed to the US amortization criteria for revenue purposes in allocating benefit over time could result in an assessment of subsidisation which is not always perfectly consistent with WTO principles, and at the same time seems to run counter to some US judicial decisions.

On the other hand, some of the changes introduced by the administrative regulations of 1998 and the US case law are in keeping with the spirit of the SCMA, relying on an approach that takes more into account the specific circumstances of the investigation. For instance, the Court of International Trade has ruled that even if the company under investigation is equityworthy it is necessary to look at the particular conditions under which the capital infusion has taken place. As regards loans, the 1998 regulations provide that interest rate comparison must be made, whenever possible, with other credits received by the company under investigation. In both cases, however, it is difficult to say whether such changes were influenced by the awareness of a new multilateral approach or were just the result of an endogenous reassessment of the US practice, which would have occurred notwithstanding the new multilateral environment.

The foregoing demonstrates that there is still the possibility of a contrast between the US regime and WTO rules. We have already referred to the "US – Export Restraints" case which addresses general principles of subsidisation in the WTO rules and in the US CVD regime. In the next chapter we are going to focus on some particular rules and administrative practices that have been the subject of DSB's decisions.

# CHAPTER VII

## THE US COUNTERVAILING DUTY REGIME UNDER WTO SCRUTINY

### Introduction

The leitmotiv of the previous chapters, in which we have addressed the multilateral subsidy and countervailing duty discipline and the US CVD regime, has been the impact of the previous US system on the multilateral rules and, this notwithstanding, the possibility of some inconsistencies between the WTO regime and its US counterpart following the URAA. The latter proposition has been put to the test. Indeed, the US countervailing duty statutes and administrative practice has the lion share of the WTO CVD disputes. Leaving aside the multifaceted Byrd Amendment dispute, which extends to antidumping proceedings, nine out of the eleven countervailing duty cases that involve, at least, the establishment of a WTO panel concern the US CVD statute and administrative practice. The following sections concentrate on the WTO reports that deal with controversies involving the post 1995 reform countervailing duty regime of the United States. A common question underlies the examinations of the various disputes in which the US participated: were the measures evaluated by the panels and the Appellate Body protectionist? If so, did the WTO decisions deal effectively with the protectionist tendencies in the US system, of which the measures in question were an expression?

Although the subject of the disputes on the CVD regime are various and distinct they have a common feature: they address only specific aspects of the US statute and administrative practice and on the other side only specific aspects of the WTO discipline, rather than the general concepts underlying its rules on subsidies and countervailing measures. The WTO disputes appear to demonstrate the absence of a key stone to ascertaining protectionism and of general parameters to verify its occurrence and its effects. Thus, in chapter IV we gave the broad picture of the SCM Agreement as interpreted by the WTO panels and by the AB. In this chapter we must go further into the details of the Agreement contrasting it to specific aspects the countervailing regime in force after the URAA in the Unites States. For instance, in chapter IV, describing the key feature of subsidisation we noted that the main benchmark is the market. Here, however, we must proceed in the analysis and inquire which kind of market we must refer to with reference to a specific case like the provision of goods and services by public authorities. Is the market in the exporting country the only available benchmark or can it replaced by other parameters and if so under which circumstances? Likewise, also with regard to US statute and administrative practice the question is whether the benefit once bestowed acquires an autonomous existence irrespective of different stages in the production process and of new ownership and terms of sale. From chapter IV we also know that the terms "entrust and direct" imply an affirmative action by the government, but which form can this affirmative action take? Finally, we have seen in the overview of the SCM Agreement that Art. 11.9 an investigation cannot be initiated if the "de minimis" requirement is not satisfied. However, must this requirement be fulfilled in an Art. 21 sunset review despite the silence of the text, or does the omission in the text not allow the analogy, as argued by the SAA?

The first three sections, therefore, deal with particular aspects of the building blocks of "subsidy", under Art 1 of the SCMA: benefit and financial contributions.

In particular, section 1 focuses on the question of the geographical and economic features of the market of reference with regard to the provision of goods and services under Art. 1.1(a)(iv).

Sections 2 and 3 deal with the question of subsidy pass-through. Pass-through can occur in two ways: a) when a subsidised product is an input in the manufacture or production of a merchandise which, in turn, is the subject of a countervailing duty proceeding; b) when a subsidy is conferred on a company which is taken over wholly, or in part, by another company. In section 2 we examine, from the angle of the WTO rules, a case related to the upstream subsidisation rules analysed in chapter III with reference to the US regime prior to the URAA. The question is whether the administering authority can skip the pass-through assessment when it is allowed to avoid the upstream subsidies investigation requirements otherwise imposed by the US statute itself.

More complex is the question examined in section 3: can subsidies - specifically "non-recurring" subsidies – bestowed on companies (prevalently, government-owned corporations) taken over by private firms pass through to the acquiring company, even though the deal is at arm's length and at fair market value? The section gets the lion's share of the chapter firstly because the analysis deals with a two-level game, as the mostly Western European companies affected by never-ending countervailing duties have carried their battle on two fronts: directly before the US trade courts, and by the intermediary of their governments, and in particular of the European Communities in the WTO. Both the judgements of US courts and WTO reports look at the same issue, but the legal benchmarks in the two systems do not coincide. Indeed, the US courts have focused on the consistency of Commerce's determinations with the principles of sect. 771(5)(F) of the Tariff Act as amended, according to which the sale of a firm at arm's length does not automatically extinguish the prior subsidy conferred.[1] On the other hand, the WTO reports assess the legality of the administering authority's determination

[1] USC§1677(5)(F)

as well as the legitimacy of the US statute itself in the light of the SCM Agreement and Art VI of GATT 1994. Secondly, the issue of the change in ownership has political relevance, because it is one of the main irritants in the relationship between the United States and the European Communities and because the US after having encouraged the privatisation drive both in industrial and developing countries, has failed to recognise, rightly or wrongly, the outcome of such policies when its countervailing regime is concerned.

The fourth section addresses a particular hypothesis of indirect financial contribution: the entrustment and direction of private parties. The case under review revolves around an example of "East Asian dirigisme", through which governmental authorities influence the decisions of entities outside the government sector, without recurring to explicit regulations or orders but impinging on the logic of the market. Two alternatives are at stake, both of which are potentially trade distorting: the failure to view as a subsidy heavy-handed governmental interference with market choice can allow an allocation of resources non-consistent with market orientation, which in turn could severely affect international trade to the advantage of the country resorting to such measures. On the other hand, viewing such policies as a form of subsidisation, even if they do belong to quite a different form of government intervention, could provide the importing country with an easy protectionist tool. The choice between these alternatives depends on the interpretation of the relevant provision in Art. 1 of the SCM Agreement. In interpreting the Agreement the panel and the Appellate Body adopted quite different philosophies, and the AB's decision is likely to have a powerful impact on the relationship of the United States and of the European Communities with many trade partners particularly in the Far East.

The fifth section deals with the assessment of injury in countervailing duty investigations and, more in depth, with the parameters applied on "de minimis" subsidisation in initial investigations and in sunset reviews. Also in this case the interpretation of the relevant articles of the SCM Agreement can have a protectionist impact. What is at stake is the possibility of continuing to impose CVD duties in spite of the fact that the requirements for starting an investigation are no longer satisfied.

In contrast with the previous sections, the dispute examined in section 6 does not deal with a particular aspect of the relationship between the US CVD regime and the SCM Agreement but has a much wider, almost philosophical, scope: the boundary of what constitutes countervailing duty (and antidumping) proceedings. The Byrd Amendment case is relevant both because of its political impact and legal implications, as many WTO members, including the EU, Canada and Japan, have repeatedly announced that they are poised to withdraw concessions on the import of US products because of the protracted unwillingness of Congress to repeal the Act, The dispute has also put into question the effectiveness of multilateral remedies provided by the Dispute Settlement Understanding in face of the unwillingness of a WTO member to conform its measures to the opinion of the competent WTO body.

**1)The market of reference in the in the provision or purchase of goods by governments**

The question of the geographical market to be used as benchmark and of the requirements for this market was raised in the last round (US-Softwood Lumber IV) of the never-ending quarrel between Canada and the United States over countervailability of exports of Canadian lumber wherein the Canadian government and provincial authorities applied favourable stumpage prices which, according to the US administering authority, resulted in subsidisation.[2]

The question is apparently solved by the cited Art. 14 of the Agreement, which, while providing for adequate remuneration in the provision or purchase of goods by governments as a condition to avoid the application of countervailing measures, states that "the adequacy of remuneration shall be determined in relation to prevailing market conditions...in the country of provision or purchase"

The United States, however, in keeping with the1988 Regulations, argued that it was impossible to apply the "in-country price" benchmark with reference to the Canadian market because timber market prices in Canada were not reflective of the fair market value due to the near-total dominance of the government in the Canadian timber trade, which forced private timber sellers to align their prices to the administered prices set by the government and provincial authorities. In the US view, therefore, the comparison to the market in order to establish the existence of benefit referred to a market undistorted by governmental practice. In the absence of such a market in the exporting country the yardstick was to be provided by the conditions prevailing in the importing country's market.

The panel rejected the US argument referring first to Art. 31 of the Vienna Convention on the Law of Treaties, according to which the interpretation of a treaty must be based on the text. The panel argued that the sentence "in relation to prevailing market conditions" should be interpreted as in comparison with the conditions prevailing in the domestic market in the country of provision and,

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[2] See chapter VI,pp.221 et seq..

consequently, the data to be used for the assessment of adequacy of remuneration were those reflecting the prevailing market conditions in that country.[3]

The panel acknowledged that the absence of an undistorted market in the exporting country created a significant loophole in Art. 14(d). However, it was of the opinion that such a discrepancy should be solved by further negotiations and that under the text of the article, which bound the parties as well as the judge, as long as there are prices determined by independent operators there is a market to which the comparison with price offered by public authorities must be referred, "even if supply and demand are affected by the government presence in the market".

The Panel's interpretation of article 14, however, has been overturned by the Appellate Body. The Appellate Body started by dismissing the US approach according to which the term "market conditions" refers necessarily to a market undistorted by a government's financial contributions, as unwarranted by the text of the article. On the other hand, with a rather daring interpretation of Art. 14(d), it argued that the text allows benchmarks other than private prices in the providing market. This possibility results from the fact that the expression "in relation to prevailing market conditions in the country of provision" may not be interpreted exclusively as "in comparison with" but rather "as regards" and "with respect to" the conditions of that particular market.[4] Such alternative interpretations, in the opinion of the Appellate Body, finds support in the chapeau of the article, which refers to "any method used by the investigating authority", thus implying that

[3] United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada. Report of the Panel (23.8.2003). WT/DS257/R, paras 7.57-7.59.
[4] United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada. Report of the Appellate Body (19.1.2004). WT/DS257/AB R., para. 89.

more than one method consistent with article 14 is available.[5]The Appellate Body also argued that the panel's interpretation runs counter to the meaning of "benefit", a mainstay of the article, which implies that the financial contribution must make the recipient better-off than it would otherwise have been without that contribution. Indeed, in a private market distorted by government interference the comparison to that particular market could result in a benefit nearing zero [6] From the foregoing the Appellate Body inferred that benchmarks other than prices in the exporting country's market can be used if the latter are severely distorted by the government's predominant role, and as long as the alternative benchmark, which could refer to the importing country's market, is related or connected to the market of export.[7]

In the case in question, therefore, the Appellate Body upheld, in principle, the US outlook, even though it rejected its reasoning as not being based on the text of the SCM Agreement, as required by Art. 31 of the Vienna Convention on the Law of Treaties. However, it did not deduce from the foregoing that the method actually applied in the Soft Lumber countervailing duty determination was necessarily the right one. Indeed, the Appellate Body argued that the conditions for the application of an alternative method referring to private stumpage in the bordering states of the Northern United States have yet to be verified. In particular, the question of actual distortion of the Canadian private market as well as cross-border comparability between the US and Canadian markets need further proof.[8]

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[5] Ibid. para 91.
[6] Ibid. para. 95.
[7] Ibid. para. 102-103.
[8] Ibid. para. 117.

The interpretation provided by the Appellate Body presents some difficulties.

Firstly it seems that the Appellate Body considered the offset of "the effects of the subsidy" as the pivotal objective of the agreement and, therefore, inferred that any benchmark in the assessment of the benefit must be bent to such an objective, coming to the conclusion that to achieve this end a plurality of yardsticks can be used if need arises.[9] On the contrary, the history of the SCM negotiations clearly bears out that the text of the agreement is the result of a lengthy, difficult and still uncertain bargaining of contrasting goals. It seems, therefore, more consistent with political prudence to abide by a single parameter, at least as long as a new consensus has not emerged. It must be remembered that the Panel honestly recognised the difficulties presented by the text of article 14, but thought that the overcoming of such difficulties was not a task for the interpreter but had to be left to a reform agreed by the parties.

Nor does the interpretation put forward by the Appellate Body provide stable ground to determine when one must consider the market as significantly distorted by the dominant position of public authorities, or when the importing country's market is sufficiently related to the export market.

Secondly, the remedy could be worse than the illness. Even if the above-mentioned conditions are realised, there is the possibility that the market in the importing country is also affected by governmental intervention. Even worse, at least from the exporter's viewpoint, the relevant market in the importing country, though free from state intervention, could be dominated by a few oligopolistic

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[9] See para 95.

firms whose policies increase prices and, consequently, the margin of benefit assessed on the exporting competitor.

Finally, it seems that the Appellate Body's reading of Art. 14 establishes an unwarranted link between the two sentences of the article's chapeau. Contrary to what the Appellate Body argues, the plurality of methods which the investigating authorities are allowed to use by the first sentence, as is natural given the plurality of members and domestic regimes, does not entail that each of the guidelines listed in the second sentence of the chapeau can assume different forms according to the circumstances of their implementation.

**2) Upstream Subsidies**

In Chapter III we have provided an outline of the US upstream subsidies regime prior to the Uruguay Round Agreement Act. In US – Softwood Lumber IV, Canada complained that the United States had failed to conduct a pass-through investigation in cases involving upstream subsidies.

It must be noted for a starter that the present US statute referring to upstream subsidies, under section 771A of the URAA, provides, inter alia, that the subsidised product must be used in the production of a merchandise which is the subject of a countervailing duty proceeding, and has a significant effect on the cost of the latter.[10] Thus in the US system, upstream subsidies proceedings whose requirements are further developed by section 351.523 of the final CVD regulations of 1998 - turn on two factors: 1) the distinction between subsidised input and merchandise subject to a CVD investigation and 2) the bestowal of a competitive benefit on the latter, which cannot exceed the subsidy granted on the input, but can differ in amount. No equivalent specific rule can be found in the

[10] USC§1677-1.

SCMA and in GATT 1994, which, however, more generally refer to indirect subsidisation.

However, in its softwood lumber investigation the US administering authority left out of consideration USC § 1677-1, and its constraints, as it carried out its investigation on an aggregate base, which, in its opinion, renders unnecessary a distinction between output and final product.[11] Therefore, in its final affirmative determination it caught three cases in the same net: A) log sales to lumber producers by timber harvesters that do not manufacture lumber; B) sales of logs by a tenure-holding harvester-sawmill to another unrelated sawmill; C) sales of lumber by a tenure-holding harvester-sawmill to an unrelated lumber re-manufacturer. The aggregate investigation concerned both the lumber produced by sawmills owned by tenure holding harvesters and the lumber re-manufactured by independent sawmills that did not have a timber tenure holding, whereas the subsidy was directly bestowed by the stumpage programme on the timber harvesters, which sold and processed logs directly.

Specifically, the US objected to the Canadian claim that since the investigation had been carried out on an aggregate basis, no pass-through analysis was required because the USDOC simply spread the total subsidy amount that it had calculated over the value of sales of the products produced from the lumber production process. According to the US, a pass-through analysis would effectively amount to requiring a company-specific analysis, whereas Art. 19.3 of the SCMA allows the imposition of countervailing duties also on uninvestigated exporters whenever an aggregate basis procedure is applied.[12]

[11] Notice of Final Affirmative Countervailing Duty Determination and Notice of Final Negative Critical Circmstances Determnation: Certain Softwood Lumber Products from Canada, 67FR15545 (April 2, 2002), ia.ita.doc.gov/frn/0204frn/02-7849.txt.

[12] United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Report of the Panel (29/8/2003). WT/DS257/R, paras. 7.74-7.79.

The Appellate Body, mainly upholding the rationale of the panel report, noted that Art. VI:3 of GATT 1994 by referring to "subsidies bestowed indirectly" implies that financial contributions by the government to the production of inputs used in products subject to an investigation are not, in principle, excluded from the amount of subsidies that may be offset through the imposition of countervailing duties on the processed product. On the other hand, since Art. VI:3 forbids the imposition of countervailing duties in excess of the amount of the subsidy accrued on the imported product, where the producer of the input is not the same entity as the producer of the processed product, it cannot be presumed that the whole subsidy bestowed on the input passes through to the processed product. Thus, no countervailing duties can be assessed on the downstream product unless a pass-through of the benefit has been demonstrated.[13] The AB found further support in the definition of a subsidy in Art. 1.1 of the SCM Agreement, which requires both a financial contribution and a benefit, arguing that if countervailing duties are to be imposed on the processed product, it is not sufficient for an investigating authority to establish only for the input product the existence of a financial contribution and the conferral of a benefit to the input producer.[14]

As regards the three above-mentioned cases which triggered the imposition of countervailing duties on the imports of Canadian softwood lumber in the United States, the US did not appeal the panel's finding on sales of logs by tenured timber harvesters to unrelated lumber producers. The panel held that in such a situation the obligation under Art. VI:3 of GATT 1994 and Art. 10 of the

[13] United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – AB-2003-6- Report of the Appellate Body (19/1/2004). WT/DS257/AB/R, paras 140-141.
[14] Ibid., para. 142.
The need to establish that a subsidy has been granted on the investigated products and to assess its amount had already been stated by the WTO panel in "US – softwood lumber III" concerning the August 2001 USDOC's preliminary determination in the investigation on imports of Canadian softwood lumber (WT/DS236/R, para. 7.79).

SCM Agreement to conduct a pass-through analysis in respect of production of softwood lumber from logs purchased from unrelated harvesters falls on the WTO member taking countervailing action.[15]

With regard to the other two cases, objects of appeal by the United States, the Appellate Body distinguished between sales of logs by a tenure-holding harvester-sawmill to another unrelated sawmill and sales of lumber to an unrelated lumber re-manufacturer, contrasting the subsidisation of an input product outside the investigation and the situation in which a product under general investigation is the input of another product covered by the same investigation.

In the first case, in keeping with the US viewpoint, the AB held that the carrying out of an investigation on an aggregate basis under Article 19.3 of the SCM Agreement legitimises the assessment of the overall subsidy amount, which was then distributed among the investigated products. This fact, however, does not exonerate a Member from playing by the rules of the game, that is, by assessing the total amount of subsidy and the countervailing duty rate consistently with the SCM Agreement and Article IV of GATT. Therefore, in determining the total amount of subsidy the investigating authority must check the occurrence of a pass-through between the subsidised input and the product under investigation and its amount.[16]

On the other hand, reversing the panel' s opinion, the Appellate Body held that a pass-through analysis is not required in the case of all arm's length transactions affecting timber, sawmills and remanufacturers, as both the harvester/sawmills and the remanufacturers are subject to the investigation. In this situation, therefore, it is not necessary to calculate precisely how subsidy

[15] WT/DS257/R, paras. 7.94 – 7.99.
[16] WT/DS257/AB/R, para. 156-159.

benefits are divided up between the producers of subject products in order to establish, on an aggregate basis, the total amount of subsidy and the country-wide countervailing duty rate for those subjects.[17]

As one should expect given the interests involved in the dispute, which is just a stage of a quarrel dating back to the 1980s, the story did not end here. Almost a year after the Appellate Body's report Canada requested the DSB to establish a panel under Article 21.5 of the DSU, claiming that the measures allegedly taken by the United States to comply with the DSB's recommendations and rulings were inconsistent with US obligations under relevant WTO Agreements.

In particular, Canada claimed that the DOC completely excluded entire groups of transactions from the new investigation, on the basis that these were not arm's length sales. According to Canada, a transaction between unrelated parties is by definition an arm's length transaction and, therefore, requires a pass-through analysis. In contrast, the United States, pointing out that the Appellate Body had exclusively used the term arm's length transactions whereas the panel had prevalently referred to transactions between unrelated parties, asserted that sales between formally unrelated parties are not necessarily arm's length as other factors affecting the transaction must be taken into account: in particular, some government-mandated restrictions such as limitations on log sales that are contained in Crown tenure contracts and wood supply agreements.

The panel did not entertain the question as to whether arm's length transactions are synonymous with transactions between unrelated parties, but upheld the Canadian claim just noting that, apart from sales to unrelated remanufacturers, the Appellate Body, though using another word in its reasoning,

[17] Ibid., para. 161-165.

had not overturned the panel report, either explicitly or implicitly.[18] Analogous reasoning was used by the DSU Art. 21.5 panel to overrule the US defence, based on the wording of a footnote of the Appellate Body's report, that proof of pass-through is not required for sales of logs to sawmills that do not hold a stumpage contract, i.e., to sawmills that do not hold tenures.[19]

In this case the sequence of events and the moral we can draw from them are quite simple. Overall it is an uncomplicated illustration of what we argued in the first chapter: the US countervailing duty regime does not necessarily create a protectionist environment. However, there is room for manoeuvre to exploit its rules for protectionist ends when individual CVD investigations are carried out.

In "US – Softwood Lumber IV" the US administering authority simply avoided the constraints imposed by the US statute, under USC § 1677-1, legitimately exploiting a provision (Art. 19.3) of the SCM Agreement. Nor did the WTO reports contest the legitimacy of the US statute on upstream subsidies. However, the Department of Commerce could not resist the temptation to widen the net and catch producers whose exports did not necessarily benefit from subsidies, without carrying out a proper investigation. The WTO panel and, with more accuracy, the Appellate Body made it clear that this was unacceptable and, as expected, the US administering authority had difficulty in complying.

Much more complex is the question of pass-through involving a change in ownership which we are going to examine in the following section.

[18] United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse by Canada to Article 21.5 (DS257) - Report of the Panel (1/8/2005). WTDS257/RW, paras 4.74 – 4.82.
[19] Ibid., paras 4.98-4.103.

### 3) Change in ownership and interaction between WTO reports and the evolving US case law and administrative practice

In the previous chapter we examined how the US administering authority deals with allocating non-recurrent benefits over time. Linked to the above issue is the question of determining whether and to what extent change in ownership transactions eliminate previously conferred countervailable (non-recurring) subsidies.

Let us suppose that a company receives a subsidy whose benefit spreads over ten years and that after seven years the corporation is bought by new shareholders. Does the sale suffice to cancel the non-amortised quota of the subsidy bestowed? Mostly, the answer is negative, though the Department of Commerce has repeatedly conceded that the purchase price can be attributed "pro quota" to the repayment of the subsidy, which, therefore, does not entirely pass-through.

What, however, if the purchase price is a fair-market price which has been agreed by non-related parties? It has been contended that in such a case the subsidy is entirely extinguished. Indeed, non-recurrent subsidies almost always entail cost curtailments, which once capitalized reduce the book value of the fixed assets to which the subsidy is allocated below their real market value. There are, therefore, prospective capital gains if the assets are sold, along with an increase in the net worth of the subsidised company and its goodwill. In short, gains can be expected when assets, or a permanent establishment, or the whole enterprise are sold. Things change once the fair market value sale has occurred, as there are no prospective capital gains, because the consideration paid by the buyer factors in the benefit inherent to the subsidy.

This point of view was originally accepted by the United States. In "Lime from Mexico", which dealt with the privatisation of a government-owned company, Sonocal, Commerce stated that to the extent that the price paid for a government-owned company reflects its market value there is the presumption that the previously bestowed countervailable benefits are fully reflected in the purchase price and, therefore, are not passed-through to the purchaser.[20]

Commerce's viewpoint, however, changed in the following years. In particular, in "Certain steel products from Austria", whose General Issues Appendix (GIA), as we know, was a benchmark for subsequent determinations, the administering authority held that privatization of a government-owned company, per se, cannot eliminate countervailability, since "the statute does not permit the amount of the subsidy, including the allocated subsidy stream, to be re-evaluated based upon subsequent events in the marketplace". The Department, therefore, argued that only a proportion of the purchase price can be attributed to prior subsidies, and estimated it according to the rate of the privatized company's subsidies relative to the company's net worth during the period prior to the privatisation.[21]

Commerce applied the GIA approach with reference to the privatization of two subsidised government-owned companies: Saarstahl and British Steel. The Court of International Trade rejected this methodology, reasoning that the purpose of countervailing duty laws is not "to capture" a subsidy once bestowed, but to offset subsidies on goods entering the US market so that American producers of

[20] Preliminary Results of Changed Circumstances Countervailing Duty Administrative Review. Lime from Mexico. 54Fr 1753. January 17,1989). web.lexis-nexis.com/professional.
[21] Final Affirmative Countervailing Duty Determination: Certain Steel Products from Austria. 58 FR 37217, 37263. July 9,1993.web.lexis-nexis.com/professional.
Commerce provided the following example: A company with $ 60 in remaining subsidies is sold for $ 72. Between 1977, first date of relevant subsidisation, and the date of privatisation, subsidies averaged ¾ of the company's net worth. In this case, ¾ of the purchase price ($ 54) should be attributed to repaying those subsidies, reducing them fro $ 6o to $ 6. If the average subsidies to a company during the period from 1977 to the date of privatisation exceeded the average net worth of the company, then the entire purchase price would be treated as a repayment of those subsidies.

competing goods are not at a disadvantage. The CIT, therefore, argued that in the change of ownership at issue there was no countervailable subsidy because the buyer in a market-based, arm's-length transaction pays for all it receives and, therefore, obtains no competitive benefit.[22]

Congress promptly countered the threat caused by the Court's decision, introducing through the URAA a new subsection of the Tariff Act of 1930. Section 771(5)(F) provides that "a change in ownership of all or part of a foreign enterprise does not by itself require a determination by the administering authority that a past countervailable subsidy received by the enterprise no longer continues to be countervailable, even though the change in ownership is accomplished through an arm's length transaction".[23] The text, thus, lets us infer that an additional element could be required for the countervailable subsidy to be extinguished, though Congress refrained from specifying such an additional factor, leaving its identification to the investigations carried out by the administering authority. The Statement of Administrative Action (SAA) points out that "section 771 (5) (F) aims at preventing "any extreme interpretation" by which someone might argue that "all that would be required to eliminate any countervailing duty liability would be to sell subsidised productive assets to an unrelated party". However it must be emphasised that, as noted by the WTO panel in "US-Countervailing Measures on Certain EC Products", although section 771(5)(F) refers only to arm's length transactions, both the reports of Congress on the relevant legislation and the US case law implied that arm's length transactions necessarily occur at fair market value.[24]

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[22] Saarstahl AG v. United States, 18 CIT 525; 828 F.Supp. 187 (1994).

[23] 19 USC § 1677 (5)(F).

[24] United States-Countervailing Measures Concerning Certain Products from the European Communities – Report of the Panel (31.7.2002).WT/DS212/R, para. 7.130.

The CIT's decision in Saarstahl was reversed by the Court of Appeals for the Federal Circuit which stressed that the CIT had made an "improper equation of subsidy and competitive benefits, which was not the intention of Congress". On the contrary, in the opinion of the Federal Circuit, the lawmakers on many occasions expressed the view that "an effect test for subsidies has never been mandated by the law and is inconsistent with effective enforcement", the only requirements for the imposition of countervailing measures being the provision of subsidy and injury to a domestic industry.[25] From the foregoing the Federal Circuit drew the conclusion that the Court of Trade erred in holding that as a matter of law a subsidy cannot be passed through during an arm's length transaction, whereas Commerce's methodology correctly recognised that a number of scenarios are possible.[26]

However, in the first place the Appeal judges stressed that their decision was based on the statutory scheme prior to the Tariff Act amendment. Secondly, the Federal Circuit gave deference to the long established principle of the judicial review of administrative proceedings, according to which the reviewing court must respect policy choices made by US agencies in applying statutes, as long as they "fall within the range of permissible constructions", even though the construction applied by the agency is not the only reasonable one and does not coincide with the result that the court would have reached had the question arisen in the first instance in judicial proceedings.[27]

In the Final Regulations of 1998 there is no section assigned to the change in ownership issue. However, the preamble to the Regulations states that the

[25] Saarstahl AG v. United States, Court of Appeals for the Federal Circuit,78 F.3d 1539, 1543 (1996). web.lexis-nexis.com/professional.
[26] Ibid.,1544.
[27] Chevron USA Inc. v. Natural Res.Def.Council,Inc, 467 US 837, 842-43 (1984).
See Elizabeth C. Seastrum , "Chevron Deference and The Charming Betsy: Is There a Place for the Schooner in the Standard of Review of Commerce Antidumping and Countervailing Duty. Determinations?", *Fed. Cir. B.J.* 13 (2003-4), p. 230 et seq. web.lexis-nexis.com/professional..

language of section 771 (5)(F) neither requires nor prohibits a determination that prior subsidies are no longer countervailable, but leaves the administering authority with the discretion to determine on a case-by-case basis the impact of a change in ownership on the countervailability of past subsidies.[28] The 1998 Final Rule also adds that the above described repayment/reallocation methodology, adopted by Commerce achieved the objective of flexibility in assessing benefits in change in ownership cases. Commerce's methodology might have been flexible for US CVD purposes, but very soon it was found to contravene the new multilateral rules on subsidies and countervailing measures.

*Change in ownership at arm's length, fair market value under WTO scrutiny: first stage*

The first WTO test of the US approach on change in ownership involved the United Kingdom offshoots, in private holding, of the complex privatization of a government-owned company, British Steel Corporation (BSC), carried out in various stages, the last of which took place in 1995.

In its 1993 final affirmative determination, Commerce, clarifying the principle underlying the repayment/reallocation methodology (also known as the Gamma method), claimed that the sale of a business or productive unit does not alter the effect of previously bestowed subsidies, which, therefore, at least in part, continue to be enjoyed by the productive unity, though under a new owner.[29] This approach was confirmed in subsequent administrative reviews.[30]

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[28] Countervailing Duties, Final Rule, 65354.ia.ita.doc.gov/regs/98-30565.txt.
[29] Final Affirmative Countervailing Duty Determination: Certain Hot Rolled Lead and Bismuth Carbon Steel Products from the United Kingdom. 58FR6237, 6240, January 27, 1993. web.lexis-nexis.com/professional.
Among others, Commerce stated quite poetically that as the company disposes of its productive entities, these entities take a portion of the benefits with them when they "travel to their new home".
[30] Certain Hot Rolled Lead and Carbon Steel Products from the United Kingdom,60FR54841 (October 26,1995). web.lexis-nexis.com/professional
Certain Hot Rolled Lead and Carbon Steel Products from the United Kingdom. 61FR58377 (November 14,1996). web.lexis-nexis.com/professional

The European Communities claimed that the affirmative determinations from 1995 (year of entry into force of the WTO Agreement) to 1998 were inconsistent with article 10 of the SCM Agreement read in conjunction with articles 1, 14 and 19 of the Agreement and Art. VI:3 of the GATT 1994, as they failed to take all the necessary steps to demonstrate the existence of a subsidy.[31]

The European Communities did not deny that a financial contribution was made to the government-owned company BSC, which received a benefit, but contended that the reviews failed to inquire as to whether a benefit and, therefore, a subsidy was conferred or not on the privately-owned companies (BSC and BSplc/BSES) created in the course of the privatization process, whose products continued to be subjected to US countervailing duties. In the opinion of the European Communities, the bestowal of a benefit implies a comparison between the terms of the financial contribution and those otherwise available to the recipient.[32] In this context, according to the EC, when a private buyer purchases a company or assets thereof in an arm's-length transaction at market value the payment of market price necessarily precludes, as a basic matter of economics, the passing through of any benefit to the new private owner. Indeed, the price paid necessarily values and incorporates within the transaction any subsidy previously

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Certain Hot Rolled Lead and Carbon Steel Products from the United Kingdom, 62FR53306 (October 14,1997). web.lexis-nexis.com/professional
Certain Hot Rolled Lead and Carbon Steel Products from the United Kingdom,63FR18367 (April 15,1998). web.lexis-nexis.com/professional.

[31] Specifically, Article 10 of the SCM Agreement requires that a WTO Member should take all necessary steps to ensure that countervailing duties are imposed by its authorities only in conformity with the terms of the SCM Agreement; Article 19.1 establishes that a Member may impose countervailing duties only after making a final determination of the existence and amount of a subsidy; Article 19.4 ASCM requires that no countervailing duty shall be levied on any imported product in excess of the amount of the subsidy found to exist; and Article VI:3 of GATT 1994 sets forth the same obligation, requiring that no countervailing duty shall be levied on any product in excess of an amount equal to the subsidy determined to have been granted.

[32] United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products originating in the United Kingdom – Report of the Panel. WT/DS138/R – Attachment 1.1 – First Submission of the European Communities – Legal Arguments, paras 81 et seq.

conferred; and if the subsidy increases the value of the company, so will it increase the price the purchaser must pay.[33]

The United States replied that the SCM Agreement only provides for the ascertainment of the existence of a subsidy, including a subsidy benefit, as of the time of the subsidy bestowal, but it says nothing as to whether the investigating authority should take account of a change in ownership.[34] On the other hand, it argued that the text of the Agreement, and in particular Art. 27.13, suggests that previously bestowed subsidies remain actionable and are allocable to a successor company's production.[35] In the US view, therefore, in line with the approach followed in Commerce's investigations, the determinative factor is the productive asset, rather than the owner, as Art. 10 of the SCM Agreement and GATT 1994 Art. VI.3 refer to the subsidy as having been bestowed, directly or indirectly, upon the manufacture, production and export of the product.

The panel based its opinion on some of the basic concepts underlying the nature of subsidy that had already been examined in previous cases, reported in chapter IV. In particular, the panel focused on the notion of benefit, recalling that in "Canada - Aircraft" the Appellate Body pointed out that such a notion implies both the existence of a recipient and a comparison with the marketplace, from which the conclusion can be drawn that the recipient has been made better-off by the financial contribution.[36] Relying on this premise the panel rejected the US viewpoint according to which the benefit is conferred on the production and export of merchandise, irrespective of the person producing and exporting the

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[33] WT/DS138/R – Attachment 1.1 – First Submission of the European Communities – The Economics of Privatization, paras 50-61.
[34] WT/DS138/R – Attachment 2.1 – First Submission of the United States – Legal Arguments, paras. 108 et seq.
[35] Actually, SCMA Art. 27.13 only provides that "the provisions of Part III (actionable subsidies) do not apply to subsidies granted within and directly linked to a privatization programme of a developing country".
[36] United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products originating in the United Kingdom- Report of the Panel (23.12.1999). WT/DS138/R, paras 6.64-6.65.

product. Nor, in the opinion of the panel, can the investigation be confined to the person that received the subsidy at the date of bestowal of the financial contribution. On the contrary, the text of Art. 1.1 and Art 21 (on review of countervailing duties) makes it clear that the establishment of both the existence of financial contribution and benefit must refer to the relevant period of investigation and review.[37] As regards Art. 27.13 the panel noted that its scope was strictly limited to the particular case of the privatization of companies in developing countries and could not be applied to the more general question of persistence of the benefit originally bestowed in change in ownership cases.[38]

From the foregoing, the panel drew the conclusion that the continued existence of a benefit must be demonstrated with reference to the successor companies in private ownership that exported goods to the USA during the periods of investigation (POIs) covered by the subsequent administrative reviews. In the panel's view, change in ownership by itself is certainly not enough to extinguish the subsidy since the "non-recurring" financial contribution can be deemed to have been invested in the productive assets acquired by private ownership companies, which, therefore, could indirectly receive the benefit embodied in those assets. However, when fair market value is paid for all productive assets and goodwill acquired by the exporting companies in private holding, a benefit cannot be deemed to exist because, as argued by the European Communities, the purchaser is not better off with regard to the terms of the market.[39]

The panel, therefore, concluded that the methodology applied by the United States in the administrative reviews at issue violated Article 10 of the SCMA and, pursuant to Art. 19.1 of the Agreement, recommended that the US

[37]Ibid., para 6.71-6.74.
[38]Ibid., para 6.76.
[39]Ibid., paras 6.80-6.81.

should bring the measures imposed on the imported British products into conformity with the SCM Agreement.[40] However, the panel did not accede to the request of the Communities to suggest that the United States amended its countervailing duty laws to recognise the principle that privatization at market price extinguishes subsidies, holding that there was no provision of US law that required the imposition of countervailing duties in the circumstances of the dispute.[41]

The Appellate Body upheld the panel's finding that no benefit was conferred on the private ownership companies, UES and BSplc/BSES as a result of the financial contributions made to BSC, having regard, however, to "the particular circumstances of this case".[42] This seems to indicate that in the AB's opinion, an arm's length and fair-market value transaction is not by itself and in all circumstances enough to offset the benefit bestowed by the financial contribution to the original owner.

*<u>The first response of the US courts: the Delverde case</u>*

A few months after the panel report the Court of Appeals for the Federal Circuit reversed a decision of the Court of International Trade which upheld a final determination of the USDOC on imports of pasta produced by Italian firms.[43] The case concerned the take-over of an Italian company, this time in private ownership, which had received subsidies from the government. The Federal Circuit stated that the Tariff Act as amended does not allow Commerce to presume that the subsidies granted to the prior owner of corporate assets automatically pass through to the firm that runs the business following a change in

[40] Ibid., para.6.81.
[41] Ibid., para.6.82.
[42] WT/DS138/AB/R, paras. 67-74..
[43] Final Affirmative Countervailing Duty Determination: Certain Pasta from Italy, 61FR 30288,June 14, 1996. web.lexis-nexis.com/professional/.

ownership. Rather, the Tariff Acts requires that the administering authority should make such a determination by examining the particular facts and circumstances of the sale.[44] Thus, according to the Court, if section 771(5)(F) makes it clear that a subsidy cannot be considered to have been extinguished by an arm's length transaction, it does not provide for the opposite either. Nor does the provision direct Commerce to use any particular methodology. The section simply prohibits a "per se rule" either way, and with regard to arm's length transactions confirms the general requirement that Commerce should determine that a government provided both a financial contribution and benefit to a person, either directly or indirectly, before imposing countervailing duties.[45]

Applying this reasoning to the facts in "Delverde", the Federal Circuit concluded that since the repayment/reallocation methodology boils down to a "per se rule" according to which a subsidy is deemed to pass through to a new entity, though pro quota, it contravened the CVD statute and section 1677 (5)(F) in particular.[46] It must be noted that the Court of Appeal declined to give deference to Commerce's interpretation of the statute, as provided by the Chevron decision, because, in its opinion, the meaning of the statute was unequivocal and the approach of the Department fell outside the range of permissible interpretations.[47] The Federal Circuit Court also pointed out that the statutory context had changed from that on which its previous Saarstahl decision was based, since the Tariff Act as amended by the URAA gives a definition of subsidy, which includes both financial contribution and benefit. The claim of the Italian company, therefore, did

[44] Delverde, SRL and Delverde USA, Inc. v. United States, 202 F3d 1360, 1365 (2000)web.lexis-nexis.com/professional.
[45] Ibid.,1366.
[46] Ibid.,1368
[47] Ibid.,1367.

not concern the effect of an already granted subsidy, but the continuous existence of the benefit and, therefore, of the subsidy itself.

Thus, although the Federal Circuit stressed that its decision was exclusively based on US statutes and that it did not consider the relevance of the WTO panel's decision, both the WTO and the Federal Circuit essentially agreed that Commerce cannot presume a benefit in order to find a subsidy in the privatization context.[48]

*Change in ownership at arm's length, fair market value under WTO scrutiny: second round*

The Department of Commerce continued to apply the Gamma method for a certain while, but from 2001 adopted a more elaborate "same person" methodology, which, however, led to equivalent results. This method, which was first applied in Grain Oriented Electrical Steel from Italy, provided for a two-step test.[49] The first step consisted of an analysis of whether the post-privatization entity was the same legal person that received the original subsidy before privatization. For this purpose, the USDOC examined the following non-exhaustive criteria: 1) continuity of general business operations; 2) continuity of production facilities; 3) continuity of assets and liabilities; and 4) retention of personnel. If, as a result of the application of these criteria, the USDOC concluded that no new legal person was created, the analysis of whether a benefit exists stopped there, and the Department of Commerce did not assess whether the privatization was at arm's length and for fair market value. If, applying the above-listed criteria, the administering authority concluded that the post-privatization entity was a new legal person, distinct from the entity that had received the

[48] Julie Dunne, "Delverde and the WTO's British Steel Decision Foreshadow more Conflict where the WTO Subsidies Agreement, Privatization, and United States Countervailing Duty Law Intersect", Am. U. Int'l L. Rev.17 (2001)79.
[49] Final Results of Countervailing Duty Administrative Review: Grain Oriented Electrical Steel from Italy, 66FR 2885, January 12,2001.www.ia.ita.doc.gov/frn/0101frn/01-975.txt

subsidy prior to privatization, the USDOC would not impose duties on goods produced after the take-over.

The European Communities filed a WTO challenge to twelve affirmative determinations adopted in the course of both new investigations and administrative and sunset reviews, applying in ten cases the Gamma method and in two cases (the above-mentioned Grain Oriented Electrical Steel from Italy and Cut-to-length Carbon Steel Plates from Sweden) the "same person" method.

Once again the panel pointed out that in original investigations as well as in administrative and sunset reviews, the US administering authority, having been informed of the privatizations by the interested producers and by the European Communities, was obliged to re-examine whether the privatized producer continued to receive any benefit from the prior subsidization before reaching any conclusion that countervailing duties should be continued.[50]

The panel, rejecting the US contention - consistent with the "same person" methodology – that the company as a productive and legal entity must be distinguished from its owners – reiterated that if upon privatization, fair market value is paid for productive assets and goodwill of the government-owned company "the privatized producer will not have received a benefit or any advantage, because it has received nothing for free: all assets which it has acquired, further to the privatization transaction, have been fully paid for under normal market conditions, and it is those market conditions that serve as a benchmark for assessing the benefit to the privatized producer, as envisaged in Article 14 of the SCM Agreement".[51]

[50] United States-Countervailing Measures Concerning Certain Products from the European Communities – Report of the Panel (31/7/2002). WT/DS212/R, paras.7.70, 7.96-7.98 and para.7.111.
[51] WT/DS212/R,paras.7.72, 7.76.

Going a step further, the panel also reversed its statement in "US –Lead and Bismuth II", and argued that section 771(5)(F) is not consistent with the SCMA requirements if viewed in the context of the US CVD system as a whole. In the panel's opinion, the section's statutory language on its own would not mandate any violation of the SCM and WTO Agreements. However, the legal history of the section, the SAA, as well as the Federal Circuit's judgement in Delverde, which in a common law system is binding on subsequent cases, show that section 771(5)(F) must be interpreted as preventing a "per se" rule that privatization at arm's-length and for fair market value extinguishes the benefit for the privatized producer. Therefore, according to the panel, the Department of Commerce is prevented from developing any methodology implementing the section whereby it is required to find that the benefit from a prior financial contribution is extinguished vis-à-vis the privatized producer solely by arm's-length privatizations at fair market value. The panel, therefore, held that the aggregate effect of the legislative history, object and purpose of section 771(5)(F), the SAA, and the interpretation of that legislation by the Federal Circuit is to mandate an application of Section 771 (5)(F) that is inconsistent with Articles 10, 14, 19, and 21 of the SCM Agreement and that the United States has, thus, failed to ensure conformity with the SCM Agreement as required by Article 32.5 of the Agreement and Article XVI.4 of the WTO Agreement.[52]

In the appeal, which did not involve the "gamma method" issue, the viewpoint of the Appellate Body partially diverged from the opinion of the panel. The AB affirmed the panel's finding that the "same person" method is inconsistent with the SCM requirement of the existence of proof of benefit, because it prescribes the conclusion that, when the CVD investigation determines

[52]Ibid., paras7.156-7.158.

that no new legal person is created as a result of privatization, the newly-privatized enterprise continues to receive the benefit of a previous financial contribution without any further analysis, and irrespective of the consideration paid by the new owners.[53] On the other hand, clarifying what it had just hinted at in "US- Lead and Bismuth II" the AB overturned the panel's conclusion that privatization at arm's length and fair market value automatically entails the extinction of subsidy and that, consequently, sect. 771 (5)(F) of the Tariff Act by not providing unconditional recognition of such effect is inconsistent with the US obligation under the GATT 1994 and the SCM Agreement.[54]

The Appellate Body in the first place noted that every privatization process takes place within the concrete circumstances prevailing in the market in which the sale occurs and the outcome of such a process, namely the price that the market establishes for the state-owned enterprise, will reflect those circumstances. On the other hand, governments may impose policies that, "albeit respectful of the market's inherent functioning, are intended to induce certain results from the market". "In such circumstances, the market's valuation of the state-owned property may ultimately be severely affected by those government policies, as well as by the conditions in which buyers will subsequently be allowed to enjoy property."[55] From the foregoing the Appellate Body inferred that the panel's absolute rule of no benefit from an arm's length and fair market value transactions is defensible in the context of transactions between two private parties taking place in reasonably competitive markets. However, it "overlooks the ability of governments to obtain certain results from markets by shaping the circumstances and conditions in which markets operate" and by influencing "the circumstances

[53] United States-Countervailing Measures Concerning Certain Products from the European Communities – AB-2002-5- Report of the Appellate Body (9/12/2002). WT/DS212/AB/R, para.146.
[54] Ibid.para.158.
[55] WT/DS212/AB/R, para. 123.

and the conditions of the sale so as to obtain a certain market valuation of the enterprise".[56] In the AB's opinion, therefore, the effect of arm's length privatization is just to shift to the investigating authority the burden of identifying evidence which establishes that the benefit from the previous financial contribution passes-through. On the other hand, there is no inflexible rule requiring that investigating authorities automatically determine that a benefit from pre-privatization financial contributions has expired, since this depends on the facts of each case.[57]

Relying on such a conclusion, the Appellate Body held that as the SCM Agreement itself allows investigating authorities to evaluate evidence directed at proving that the new private owner may enjoy a benefit from a prior financial contribution bestowed on a state-owned enterprise, regardless of privatization at arm's length and for fair market value, the Agreement does not conflict with section 771(5)(F) which expressly provides for such an inquiry.[58] Nor was there any question that section 771(5)(F) could mandate a particular method of determining the existence of a benefit contrary to the SCM Agreement, simply because the section does not prescribe any specific methodology.[59]

*The second US response*

The "per se rule" test was reapplied by the US courts with regard to the "same person" methodology. The case concerned one of the 12 companies subjected to the investigations referred to the WTO DSB: the state-owned French company, Usinor, Ugine S.A., which the government began privatizing in 1995 through sale of stocks to the French and international public, as well as to

[56] Ibid., para.124
[57] Ibid., para.126.
[58] Ibid., para.158.
[59] Ibid., para.159.

employees and stable shareholders. The sale was completed by 1998 at a price considered to be in accordance with fair market value. In June 1999 the Department of Commerce issued a final CVD determination applying the gamma method, but, following the Delverde decision invalidating such methodology, the same person method was applied.[60]

The Federal Circuit, affirming the CIT's decision, held that the same person methodology violated section 771 (5)(F) as well as the Delverde precedent because it relies on a "per se" rule, grounded on the alleged identity of the pre and post privatization enterprises, rather than assessing the continuous existence of the subsidy case-by-case.[61] The Court also rejected the appellant's contention that the privatization in question, unlike in Delverde, involved a sale of stocks, rather than of assets, arguing that the statute requires the evaluation of sales of assets and stocks on equivalent terms by mentioning them in the alternative: "a change in ownership of all or part of the foreign enterprise, or the productive assets of a foreign enterprise". It also pointed out that the literal argument also finds support in the legislative history of the section.[62] Even more important, rejecting the argument of one of the appellees, Allegheny Ludlum, the Federal District focused on the scope of section 771(5)(F) and finally reversed the premise underlying the preceding jurisprudence both in the US courts and in the WTO: the equivalence between arm's length and fair market value. The Court explained that the argument that arm's length transactions necessarily occur at fair market value, conflates two very distinct concepts, the former of which refers to dealings

[60] Final Affirmative Countervailing Duty Determination: Stainless Sheet and Steel in Coil from France, 64 FD 30774, June 8, 1999. ia.ita.doc.gov/frn/9906frn/99-608c.txt.
[61] Allegheny Ludlum Corp. v. United States, 367 F3d 1339, 1344 (2004) web.lexis-lexis.com/professional/.
[62] 367 F3d, 1346.

between non-related parties, while the latter concerns the point at which demand and supply intersect on the open market and in an arm's length transaction.[63]

Even before the judgment of the Court of Appeal, Commerce once again changed its methodology, exploiting, somewhat unfairly, the message of the AB report.[64] According to Commerce, the new methodology is based on the "baseline presumption" that non-recurring subsidies can benefit the recipient over a period of time normally corresponding to the average useful life of the recipient's assets. However, an interested party may rebut this presumption by demonstrating that during the allocation period privatization occurred in which the government sold its ownership of all or substantially all of a company or its assets, retaining no control of them, and that the sale was an arm's length transaction for fair market value.[65] Clearly, this shifts the burden of proof on the privatised firm, in contrast with the statement of the Appellate Body.

In analysing whether the transaction was for fair market value, the administering authority will consider whether the full amount that was paid for the company or its assets (including the value of any subsidy benefit) was the correct value under prevailing market conditions. In this regard Commerce will normally examine whether the government maximised its return, taking into account factors such as the execution of an objective analysis in determining the appropriate sale price, the imposition of restrictions on foreign purchasers or purchasers from other domestic industries, and the grant of discounts or other benefits in exchange for promises of additional future investments that private investors would not normally consider.

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[63] 367 F3d, 1348.

[64] International Trade Administration. Notice of Final Modification of Agency Practice under Section 123 of the Uruguay Round Agreement Act. 68 FR 37125, June 23, 2003. ia.ita.doc.gov/frn/0306frn/03-15795.txt.

[65] 68 FR 37127.

However, even if it is proved that the transaction was at arm's length and at market value, the parties can demonstrate that at the time of the privatization "the broader market conditions were severely distorted by the government and that the transaction price was meaningfully different from what it would otherwise have been absent distortive government action". Factors such as obstacles to the free interplay of supply and demand, the lack of sufficient safeguards against collusive behaviour and the absence of adequate enforcement of contracts and property rights will be considered together with the bestowal of legal and fiscal incentives to prospective buyers.[66] In short, Commerce claims to be the ultimate judge of the market conditions in which a privatization transaction takes place.

Where a party gives proof of distortive governmental action, the baseline presumption will not be rebutted and any unamortized amount of pre-sale subsidy benefit will continue to be countervailable.[67]

As expected, this new methodology has not marked an end to the dispute between the EC and the US. The United States started new investigations under section 129 of the URAA to comply with the DSB's decision.[68] Three sunset reviews led to further application of countervailing duties. The Communities lodged a further complaint under Art. 21.5 of the DSU claiming, among other things that the United States failed to determine properly whether there was continuation or recurrence of subsidization and injury, because it did not examine the nature of the privatizations in question and their impact on the continuation of the alleged subsidization.[69] The panel pointed out that under Art 21.3 of the Agreement, the sunset review must determine whether the privatization was at

[66] Ibid.
[67] Ibid., 37128.
[68] 68 FR 64858, November 17,2003. Notice of implementation under Section 129 of the Uruguay Round Agreement Act, Countervailing Measures Concerning Certain Steel Products from the European Communities. /ia.ita.doc.gov/frn/0311frn/03-28668.txt.
[69] United States – Countervailing Measures Concerning Certain Products from the European Communities – Recourse to Art. 21.5 of the DSU by the European Communities – Final Report of the Panel (17/8/2005) WTDS212/RW, paras. 4.9 and paras.4.17 - 4.19.

arm's length and for fair market value and whether the benefit from the non-recurring subsidies bestowed on the state-owned producer extinguished the benefit for the privatized company, and held that in two of the contentious cases the US administering authority had failed to carry out such analysis.[70]

The morale of the story seems, at first sight, quite simple. The Department of Commerce first worked out the "gamma" methodology which, after having permitted the imposition of heavy countervailing duties on unfortunate successor companies for quite a few years was held to contravene both the WTO provisions and the United States statute. Then the Department tried again with the "same person" method which was soon rejected for analogous reasons at national and multilateral levels. But the consistency of section 771 (5) (F) of the Tariff Act with the relevant WTO rules was upheld in the DSB forum. Finally, Commerce worked out a new methodology, but failed to bring the whole of its investigations in line with the decision of the DSB. Therefore, it is easy to conclude that the villain was the US Executive, while the US statute is a flexible instrument which does not contravene multilateral provisions. An overzealous panel pointed its finger at both US statute and administrative practice, but was promptly rebuked by the Appellate Body, which argued that, at least as far as privatization is concerned, an arm's length transaction for fair market price is not always enough to guarantee the extinction of non-recurrent subsidies.

But what if the first Appellate Body's proposition, according to which change in ownership at fair market value is a multifaceted case and privatization of a state-owned firm has its own special characteristics, does not stand up to closer scrutiny?

[70] Ibid., paras 7.214-7.217 and paras. 7.278-7.280.

Let us try to give substance to the apparently convincing general statement of the Appellate Body that relies on the particular economic and political sway of governmental authorities in shaping the privatization transaction environment. Certainly governments have a dominant position as well as particular interests with regard to the sale of state-owned companies, many of which are public monopolies, or play a pivotal role in the provision of financial services or in the management of key sectors of the manufacture industry. It is submitted, however, that this is not enough to exclude the fair market value effect with regard to changes in ownership. There are four hypotheses to which a subsidy pass-through test can be applied.

1) In spite of the dominant position of the governmental counterpart, the private buyer succeeds in paying a price that, in keeping with the perspective of a competitive market, takes into account assets and liabilities of the public bid, including the subsidies received by the company to be privatized. In such a case the general rule applies: there is no passed-through subsidy, as recognised by the Federal Circuit in "Alleghany Ludlum".

2) As for private companies, government authorities exploit their dominant position to impose a higher sale price than the fair market value. In such a case not only the non-recurring subsidy is not transferred to the buying company but the latter pays a premium, that is, a tax on the purchase.

3) On the other hand, as often happens, governments exploit their dominant position to favour certain prospective buyers vis-à-vis others, who end up paying a lower price than their competitors would offer if a really competitive bid occurred. This happens, for instance, when the government does not want that key sectors of the national economy go into foreign hands. In such a case, however, we are not dealing with a level playing field. Thus, it is rather doubtful

whether the parties in the negotiations are dealing at arm's length; and clearly what the buyer actually pays is not the fair market value but something less, which, therefore is not enough to cancel all or part of the subsidy. Simply, the conditions that prevent the pass-through are not present.

4) There is a more complex and subtle version of the third hypothesis, which takes place when the state-owned company is sold through a fair market value transaction, but the government bestows some financial or fiscal incentives to the buyer, whether directly or indirectly by the intermediary of the sold enterprise. The prospective buyer can obtain a soft loan to be invested in the acquisition; or the companies involved in the transaction must pay a lower registration duty or lower stamp duty. In such a case, however, the benefit to the buyer is brand new, though linked to the acquisition. Thus the administering authority must deal with a new subsidy and not with the old non-recurring subsidy bestowed on the old enterprise.

If a closer economic analysis leads to the conclusion that there is no special place for privatization cases and, therefore, the arm's length for fair market value principle is applicable to every change in ownership case, then the WTO panel was right in holding that section 771 (5)(F) – as it was then interpreted by US lawmakers and trade courts - contravenes the SCM requirement that a subsidy, with all its elements, must be proved. Indeed, the root of the problem lies in the interpretation of the article that allows, or rather solicits the administering authority to look at factors other than arm's length transaction and fair market value. This approach prevents the investigating authority from giving a straight answer to the simple question: is the new company receiving a benefit from a previous non-recurring financial contribution and to what extent?

To rescue the US statute – erroneously considered to encompass both arm's length and fair market price – the Appellate Body embarked on a convoluted interpretation of what constitutes market conditions, increasing the number of factors to be taken into account to assess a benefit beyond the scope of SCMA Art. 14. Two years later the Court of Appeals for the Federal Circuit finally made it clear that section 771(5)(F) refers only to arm's length negotiations and does not take into consideration fair market value. One can, therefore, easily infer that it is just the former element that is not necessarily enough to prevent subsidy pass-through. However, in the meantime Commerce had already adopted an apparently new "change in ownership" methodology which: 1) reaffirms the old and repeatedly condemned presumption of subsidy pass-though, though explicitly making it rebuttable, with a consequent inversion of the burden of proof on the defendant; and 2) introduces into the analysis factors other than market conditions.

One can only agree with the opinion of an American scholar according to whom the various methodologies adopted by the Department of Commerce to justify the position that certain kinds of arm's length transaction could somehow result in the subsidy being transferred along with the assets to the new buyer demonstrate that the US CVD law "continues to be more concerned with protectionism than with righting the supposed trade distorting impact of foreign behaviour".[71]

**4) The US perspective of entrustment and direction under WTO scrutiny**

Some aspects of the US administrative practice addressing the question of the entrustment and direction of private bodies to carry out government

[71] Gregory Husisian," When a New Sheriff Comes to Town: The Impending Showdown Between the US Trade Courts and the World Trade Organization", *St.John's J.L.Comm.*17(2003),pp. 464, 468.

programmes have been subjected to review in one of the last WTO disputes on countervailing duties.[72] The controversy turned on various kinds of credit assistance obtained by a Korean exporter of dynamic random access memory semiconductors (DRAM) and DRAM modules. In the affirmative countervailing duty determination the Department of Commerce held that an uncreditworthy group of companies, Hynix, had obtained loans and other forms of financial assistance, specifically as debt restructuring, from public authorities and private banks, thanks to the active involvement of the Government of South Korea.[73] In the CVD investigation the USDOC distinguished between public bodies, government-owned or government-controlled private creditors, and private creditors not owned or controlled by the Korean government, classified respectively as Group A, B, and C creditors.[74]

The Department of Commerce drew three factual inferences from the records of the investigation: 1) the government of Korea maintained a policy of supporting Hynix's financial restructuring and thereby avoiding the firm's collapse; 2) the government exercised control or influence over Hynix's creditors necessary to implement this policy; and 3) at times it used this control/influence to pressure Hynix's creditors to continue supporting the financial restructuring of the group. On the basis of these inferences, the Department drew the conclusion that, with the exception of Group A creditors, which were part of the governmental structure, virtually all of Hynix's creditors had provided financial support under the entrustment or direction of the South Korean government, and, therefore, held

[72] United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea – Report of the Panel (21/2/2005). WT/DS296/R.
[73] Amended Final Affirmative Countervailing Duty Determination: Dynamic Random Access Memory Semiconductors from the Republic of Korea, 68FR44290, July 28, 2003.
[74]Figure US-4 submitted by the United States to the Panel.

that their credit assistance fell within the remit of section 771 (5) (B) (iii) of the Tariff Act of 1930, as amended.[75]

Examining the US affirmative determination in the light of article 1.1(a)(1)(iv) of the SCM Agreement, the panel, citing the "US – Export Restraint" case, already examined in the previous chapter, pointed out that the act of entrusting and that of directing involve three elements: 1) an explicit and affirmative action, be it delegation or command; 2) that the act be addressed to a particular party; and 3) that the object of the action be a particular task or duty.[76] It, therefore, argued that the action of the government must contain a notion of delegation (in the case of entrustment) or of command (in the case of direction).[77] The panel acknowledged that the DOC could properly have established that the Government of Korea had a policy to save the group, which might well explain the participation of public bodies in the financial rescue, and had a certain capacity to influence the other creditors, whether privately owned or government controlled.[78] It held, however, that such capacity is not enough to claim that the Korean government actually entrusted or directed the latter group of creditors to participate in the financial contributions in compliance with the standard set forth in Article 1.1(a)(1)(iv) of the SCM Agreement. The panel, therefore, considered that the DOC could not properly have found that there was sufficient evidence to support a generalized finding of entrustment or direction with respect to private bodies over the period of investigation. [79]

The rationale put forward by the panel was overturned by the Appellate Body, whose decision widens the meaning of the terms "entrusts" and "directs" in

[75] USC § 1677 (5)(B)(iii).
[76] WT DS296 R, para. 7.30.
[77] Ibid., para.7.31.
[78] Ibid., para.7.175
[79] Ibid., para.7.177

SCMA Art. 1.1(a)(1)(iv), and conversely narrows the mesh of the net in which dirigiste behaviour of governments can be caught as a subsidy.

The Appellate Body sets out with the remark that the terms "entrusts" and "directs" refer to instances where seemingly private conduct may be attributed to a government for the purposes of determining whether there is a financial contribution.[80]. It holds, however, that these instances are not only linked to delegation and command. Specifically, in the AB's view, delegation is only one of the means by which a government gives responsibility to a private body to carry out one of the functions listed in paragraphs (i) to (iii) of Article 1.1(a) of the SCMA, i.e., direct transfer of funds, forgoing of revenue and provision of goods and services.[81] As regards the term "direct" the Appellate Body recognises that the term implies the provision of authoritative instructions, thus emphasising the notion of the authority of an entity, in such a case the government, over another. However, such authority can be exercised by means that "may be more subtle than a command or may not involve the same degree of compulsion".[82]

The Appellate Body does not give examples of what could constitute alternative forms of entrustment and direction. However, it points out that the provision of paragraph iv applies not only when there is an explicit and affirmative governmental action but whenever a government exercises its authority to induce a private body to act as its proxy in providing a financial contribution.[83]

[80] United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMs) from Korea – AB 2005-4 – Report of the Appellate Body (27/6/2005). WT/DS296/AB/R, para. 108
[81] Ibid., para. 110.
[82] Ibid. para.111.
[83] Ibid., para. 115.
However, it must be noted that the AB's extensive interpretation of the terms "entrust" and "direct" is not entirely confirmed by their translation into the other WTO official languages: "encomendar" and "charger" as respectively Spanish and French synonyms of entrust (see WT/DS296/AB/R, footnote 172) and "ordenar" and "ordonner" Spanish and French synonyms of "direct" (see WT/DS296/AB/R, footnote 175).

The consequences of the overturning of the panel's interpretation of SCMA Art.1.1(a)1(iv) are far-reaching. The panel, starting from the premise that positive action by government is needed for a subsidy to be granted, in the review of the evidence taken into account in an administering authority's affirmative decision, argued that each piece of circumstantial evidence should be considered individually in order to assess a finding of entrustment or direction.[84] In contrast, the Appellate Body, considering that what is relevant is the effect of the exercise of governmental authority over the activity of private parties, held that a global assessment of all pieces of evidence is required. Thus, in the AB's opinion a piece of evidence that, viewed in isolation might be of little or no probative value, "when placed beside another piece of evidence of the same nature, could form part of an overall picture that gives rise to a reasonable inference of entrustment or direction"[85]

The decision of the Appellate Body turns by 180 degrees the playing field in which the competitive game takes place between Western countries, nominally committed to a free market economy and their more recently industrialised trade partners, particularly in the Far East, whose governments pursue export-oriented

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In particular the French synonyms cast doubts on the interpretation preferred by the Appellate Body.
If instead of referring to *Le Nouveau Petit Robert* (The New Little Robert) the AB had consulted the *Grand Larousse de la Langue Française* (Great Larousse of the French Language), it would have noted that the word "charger" has several, separate meanings only three of which fit the context of Art. 1.1(a)1 of the SCMA: to burden somebody...with something; to impose something on somebody; to charge somebody with a crime, to bring evidence against...; and 1) to entrust somebody with an office or duty, 2) to entrust somebody with the care of something, 3) to entrust somebody with the task of doing something...
Likewise the word "ordonner" has three meanings, only one of which fits Art.1.1(a)1: to arrange, to organize; to appoint, to institute and to order or command.
In short, the French terms seem to fit better with the interpretation put forward by the panel.
The *Diccionario de la lengua española*, Dictionary of the Spanish Language cited by the Appellate Body, defines "encomendar" as encargar a alguien que haga algo o que cuide de algo o de alguien i.e., to give somebody the job of doing , or to entrust somebody with the care of something or somebody. The "Diccionario"defines "ordenar" as mandar que se haga algo...encaminar y dirigir a un fin, i.e., to order, to tell to do something ... to guide, to direct to a certain goal. Here too the majority of the meanings do not support the interpretation of the English text by the Appellate Body.
[84] Ibid., para.7.175-7.178.
[85] WT/DS296/AB/R, para.154.

industrial policies, and maintain rather opaque links with the private sector of the economy. In other words, policies that were considered outside the reach of WTO rules (except by the United States and later the EU) are now likely to fall within the scope of the SCMA as long as private body's activities coincide with one of the hypotheses listed in Art. 1.1(a)(1) of the Agreement.

As far as the DRAMs case is concerned, one can easily expect that the dirigiste policy of the South Korean government would escape the rigour of the SCM Agreement if the panel's viewpoint prevailed, whereas they would be found to be contravening its provisions under the Appellate Body's decision. However, it is arguable that it is not only South Korea, but also Japan and probably China that must be prepared for hardships. Besides, even though the decision refers to CVD remedies, since it concentrates on one of the building blocks of subsidy it can be extended to multilateral remedies.

The Appellate Body' report in "US-DRAMs" seems to run counter to the WTO panel's perspective in "US-Export Restraints", which kept certain forms of governmental management of the economy out of the scope of Art. 1.1(a)1(iv).[86] The Appellate Body, however, makes a distinction between the two cases. Remarking that, as acknowledged by the panel in "US – Export Restraints" entrustment and direction do not cover situations in which the result of governmental intervention in the market depends on factual circumstances and the decision of the actors in that market.[87] The argument, however, fails to note that the hypotheses of governmental intervention in the market covered by the "US – Export Restraints" case entailed: a) the exercise of sovereign authority (in particular, fiscal and customs power), b) which was designed to achieve certain economic objectives (for instance, promoting the export of processed goods over

[86] See Chapt. VI, sect. 2.
[87] WT/DS296/AB/R, para. 114.

the export of primary commodities), c) relying on the rational choice of private actors in that market. On the other hand, in cases such as "US DRAMs", private parties do not accept to act as proxy for governmental measures just out of "metus reverentialis" but because of rational choices based on economic interest. In short, the distinction between the two hypotheses is not as clear-cut as the AB argues.

**5) Injury and "de minimis"issues**

US-DRAMs from Korea also examined injury within the countervailing duty regime framework. The analysis of the panel, however, focused exclusively on the facts of the controversy and refrained from engaging in a more general examination of the US CVD injury regime, mostly relying on previous decisions on twin dumping rules.

In particular, with regard to the causal relationship between subject imports and injury under Art. 15.5 of the SCMA, Korea relied on the safeguards regime, arguing that the term "causal relation" is nearly identical with the term "causal link" found in the causation language of article 4.2(b) of the Agreement on Safeguards, and, therefore, necessarily implies a correlation between import trends on the one hand, and industry performance on the other. In contrast, the United States contended that the criteria provided by the Agreement on Safeguards are not useful in examining causation in a different type of investigation with a different object and purpose.[88] The US pointed out that, as held by the Appellate Body in "US-Lamb", serious injury is a much higher standard than material injury and therefore, there is no basis for importing a causation standard associated with a "serious" injury requirement into a

[88] WT/DS296/R, paras 7.309-7.310 and para. 7.313.

countervailing duty investigation, which is governed by a "material" injury requirement.[89] The panel, however, did not consider it necessary to tackle the distinction between the causality parameters in the Safeguards Agreement and in the SCM Agreement, because with regard to the dispute at issue the Republic of Korea had failed, in any event, to prove in the first place the alleged absence of a coincidence between import volume and injury to the United States domestic industry.[90]

Likewise, with regard to the obligation not to attribute to the imports under investigation injury caused by other factors, under the mentioned article 15.5, the WTO panel started its analysis by noting that in two Antidumping Code cases ("US-Hot Rolled Steel" and "European Communities-Tube or Pipe Fittings") the Appellate Body had clarified that the investigating authorities must appropriately assess the injurious effects of those other factors in order to prevent that "injuries caused by the dumped imports and those caused by other factors are not "lumped together" and made indistinguishable" The panel noted, however, that the AB had concurrently stated that the investigating authority was free to choose the methodology it would use to separate and distinguish the injurious effects of other factors from those of the subsidized imports.[91] From this premise it found that, contrary to Korea's claim, the United States had, as a matter of fact, analysed all the known concurrent factors listed by the Republic (non-subject imports, capacity increases by other suppliers, decline in demand, and technological and production difficulties of American competitors), though the USITC's approach had led the Commission to exclude or limit their impact on the difficulties encountered by US domestic producers.[92]

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[89] Ibid.,para.7.313
[90] Ibid.,para. 7.319.
[91] Ibid., para.7.352.
[92] Ibid., paras 7.355-7.371.

Finally, the panel declined to verify the consistency of the methodology adopted by the US to define domestic industry and imports subject to investigation with SCMA Art.15.2 and 15.4. Korea complained that in the investigation at issue the International Trade Commission had considered assembly activities by an entity in the US as sufficient for those activities to be treated as domestic shipments, even if the DRAMs were manufactured in a third country, whereas DRAMs produced in the US and assembled by a third country entity were still considered as US domestic products. According to Korea this inconsistency resulted in an artificially reduced volume of non-subject imports, and an artificially increased volume of domestic production.[93]

The panel remarked that the inconsistency identified by Korea was a consequence of the ITC's definition of the domestic industry as those producers that fabricate DRAMs in the US and those producers that assemble DRAMs in the US, and that in order to remedy this inconsistency Korea would have to challenge the ITC's definition of domestic industry by filing a claim under Article 16 of the SCM Agreement. As no claim of this kind had been filed there was no basis on which to consider that the ITC's definition of domestic industry was inconsistent with the SCMA.[94]

In "US – Carbon Steel", however, the DSB addressed not only the administrative practice with reference to a single affirmative determination, but dealt with the consistency of the US law with WTO rules. The US statute was not censured this time either.

In chapter VI we reported that the Statement of Administrative Action pointed out that the new one percent "de minimis" requirement introduced by section 703(b)(4)(A) of the Tariff Act in compliance with SCMA Art.11.9 is only

[93] Ibid. para.7.384

[94] Ibid. para.7.385.

applicable to initial CVD investigations and does not extend to reviews of CVD orders, for which Commerce will continue its practice of waiving the collection of estimated deposit if the deposit rate is below 0.5 percent ad valorem.[95] In August 1993, the USDOC determined that certain German producers of carbon steel benefited, at a total rate of 0.60 percent ad valorem, from five countervailable subsidy programs, and in the course of the sunset review - self-initiated by the Department in September 1999, pursuant to section 751 (c) of the Trade Act[96] - Commerce determined that revocation of the countervailing duties "would be likely to lead to the continuation or recurrence of a countervailable subsidy" whose likely rate was determined by USDOC to be 0.54 percent ad valorem. Thus, following an affirmative determination of the likelihood of continuation or the recurrence of injury by the US International Trade Commission, Commerce published a notice of continuation of the countervailing duties.[97] The European Communities claimed that the US statute, as interpreted by the SAA, and its accompanying regulations (sunset regulations) conflicted with the SCM Agreement, because it provided for an automatic self-initiation of sunset reviews and by failing to apply in such reviews the "de minimis" standard of 1 percent set out in Article 11.9 of that Agreement.

In the first place, the WTO panel and the Appellate Body held that the compulsory self-initiated review provided by section 751 ( c ) of the Tariff Act was not in conflict with Art. 21.3 of the SCM Agreement, dealing with the so-called "sunset review", as the SCMA article does not make the ability of investigating authorities to self-initiate a sunset review conditional on compliance

[95] See Chp. VI, sect. 6.
[96] 19 USC § 1675 (c ).
[97] "Continuation of Antidumping and Countervailing Duty Orders on Certain Carbon Steel Products from Australia, Belgium, Brazil, Canada, Finland, France, Germany, Japan, South Korea, Mexico, Poland, Romania, Spain, Sweden, Taiwan and the United Kingdom", 65FR78469, December 15,2000..

with the evidentiary standards set forth in article 11 of the SCM Agreement for the initiation of a new investigation, and does not prescribe any other evidentiary standard.[98]

As regards the "de minimis" rule, the panel argued that the rationale for the standard set out in article 11.9 is clearly that countervailing duties are to be used to counter injurious subsidisation, and the threshold set out in this provision demarcates the level below which subsidisation is deemed to be so small as to be non-injurious for the imposition of CVDs purposes.[99] From the foregoing the panel concluded that the "de minimis" standard must also be applicable to sunset reviews, as findings otherwise would compromise one of the main objects of the SCM Agreement, which is the establishment of a disciplinary framework for the imposition of countervailing measures.[100] Accordingly, it held that US CVD law and the accompanying regulations were inconsistent with the SCM Agreement in respect of the application of a de minimis standard to sunset reviews.[101]

The Appellate Body reversed the finding of the panel arguing that the original investigation and the sunset review have different goals as the latter specifically aims at establishing whether the revocation of the duty is still likely to lead to the continuation or recurrence of the injury to domestic industry. According to the AB, while in an original investigation the authorities must investigate existence, degree and effect of any alleged subsidy in order to determine whether a subsidy exists and whether such subsidy is causing injury to domestic industry, in a sunset review, the authorities must only focus their inquiry on what would happen if an

[98] United States-Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany-AB 2002-4-Report of the Appelate Body (28/11/2002). WT/DS213/AB/R, para 116.
[99] United States-Countervailing duties on Certain Corrosion-resistant Carbon Steel Flat Products from Germany-Report of the Panel (3/7/2002). WT/DS213/, paras.8.62-8.67.
[100] Ibid., para.8.79.
[101] Ibid., para.8.80.

existing countervailing duty were removed.[102] From this difference in ends and approach it follows that the automatic termination of a countervailing duty due to the fall of the subsidy below the "de minimis" threshold may be considered undesirable.[103]

Although the Appellate Body did not consider it strictly necessary to have recourse to the supplementary means of interpretation identified in Article 32 of the Vienna Convention, it found further support for its conclusions in the negotiating history of the SCM Agreement, noting that the application of a specific de minimis standard in investigations, and the introduction of a time-bound limitation on the maintenance of countervailing duties were the subject of protracted negotiations that resulted in a carefully negotiated compromise on the final texts of article 11.9 and of article 21.3 of the Agreement. Thus, the balance of rights and obligations attained by the parties to the negotiations would be upset if the "de minimis" standard provided by the former article were extended to the latter.[104]

The Appellate Body's opinion has been compared to its opinion in "Canada – Autos" in which the AB held that SCMA Art. 3.1(b) also covers contingency in fact notwithstanding the omission of the relevant language from the text, thus apparently reaching contradictory results. Meagher argues that, although the final outcome differed, the Appellate Body's approach in the two cases was consistent, even if it may seem that in "US – Carbon Steel" rely on a more literal approach to the text than in "Canada – Autos".[105] According to the scholar, in both cases the Appellate Body was willing to read omitted text in a provision but only if to do so "is consistent with the context of the provision and the object of the agreement

[102] WT/DS213 AB R, paras 86-87.
[103] Ibid., para. 86.
[104] Ibid., para.90.
[105] Niall P. Meagher, "The Sound of Silence", op.cit. p. 425.

and it does not alter, on balance, the rights and obligations of WTO members".[106] And, unlike the issue of contingency in law and in fact under Art. 3.1.(b) in "Canada – Autos", reading a "de minimis" requirement in Art. 21.3 of the SCM Agreement would have altered such a balance.

It must be noted, however, that the comparability of Article 3.1(a) and 3.1(b) on one side and Articles 11.9 and 21,3 on the other cannot be taken for granted. Indeed, the text of SCMA Art. 3.1 (a) provides for contingency in law or in fact, whereas Art. 3.1(b) is silent with regard to both kinds of contingency. In contrast, SCMA Article 11.9 provides for the termination of any investigation when the amount o th subsidy is "de minimis", whereas Art. 21.3 of the agreement simply does not reproduce this requirement with reference to sunset review proceedings. Thus, the AB in "US – Carbon steel" cannot be accused of being inconsistent with the wording of the relevant articles in the SCM Agreement.

However, the Appellate Body fails to explain why to imply a "de minimis" standard into Art. 21.3 "would upset the balance of rights and obligations attained by the parties in the negotiations", thus taking on itself a political function that was not granted by the parties to the Agreement. It seems, at any rate, that although the rationale developed by the Appellate Body could be considered well grounded, being based on the distinct function and approach of the investigations under Art. 11 and 23, it could lead to results that are not consistent with equity. As pointed out by the AB itself, an automatic time-bound termination of countervailing duties that have been in place for five years, from the original investigation or a subsequent comprehensive review, is the rule, and its continuation is the exception and thus "there must be persuasive evidence that revocation of the duty would nevertheless lead to injury to the domestic

[106] Ibid. P. 426.

industry".[107] Yet, according to the AB's interpretation of SCMA Art. 23, a factor, such as "de minimis", that would be decisive in bringing the original investigation to an end, is no longer sufficient to repeal countervailing duties at the end of the five year period.

**6) the Byrd Amendment and the boundary of the CVD regime**

If, rightly or wrongly, the US statute has been acquitted in the "change in ownership" controversy, the United States statute has been convicted without extenuating circumstances in the Byrd Amendment dispute. However, until now the death sentence has not been carried out because of the stubborn resistance of the American lawmakers.

For a long time members of Congress had tried to push through a law allowing the direct distribution of antidumping and countervailining duties to domestic producers. Just a few days before the presidential election of November 2000, they finally succeeded in passing a bill that, in the words of Movsesian, is a clear example of interest group strategy, aimed at transferring financial resources from one firm to another at the expense of the consumer.[108]

The new section 754 of the Tariff Act of 1930, introduced by the Amendment, provides that duties assessed pursuant to a countervailing duty order or an antidumping order shall be distributed on an annual basis to the affected domestic producers for qualifying expenditures. However, under the section the affected domestic producer is not the whole domestic industry injured by imports

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[107]WT/DS213/AB/R, para.88.

[108] Mark I. Movsesian and edited by David D. Caron, "International Decisions: United States – Continued Dumping and Subsidy Offset Act", *A.J.I.L.*, 98(2004), p. 154.
The legislative history bears out Movsesian's opinion that the "Amendment" was a coup de main of its proponent, Senator Robert Byrd, at the time chairman of the Senate Appropriation Committee. Indeed, the Continued Dumping and Subsidy Offset Act (CDSOA) of 2000 – commonly known as Byrd Amendment - was enacted as Title X of the *Agricultural, Rural Development, Food and Drug Administration and Related Agencies – Appropriation (P.L. 106-387)*, just preceding a Title whose heading, more in tune with the Act, is "conservation of farmable wetland".

of subsidised or dumped products but only the manufacturer, producer, farmer, rancher or worker representative who 1) petitions for an antidumping or countervailing duty order and 2) remains in operation. Qualifying expenditures comprise any expenditures incurred, after the issuance of the antidumping or CVD order, on equipment and manufacturing facilities, R&D, acquisition of technology, personnel training, pension and health care benefits to employees, acquisition of raw materials and other inputs and working capital. In other words, since the distribution of funds concerns money already appropriated by the US Treasury, it has the nature of a financial contribution, which besides this is also aimed at enhancing the competitiveness of those firms that file a petition vis-à-vis both the unfairly competing foreign producer and those domestic enterprises that fail to support the petition. It could, therefore, be argued that it has a trade distorting potential. The United States never denied that the CDSOA bestows subsidies, though section 1002 of P.L. 106-387 states that the aim of the payments to domestic firms is to offset the negative effect of "the continued dumping or subsidisation of imported products after the issuing of antidumping and countervailing duty orders".[109] In short, in the US view, the measure is a subsidy aimed at counteracting the continuation of unfair foreign trade practices.

Yet, the argument that the CDSOA can be considered as an actionable subsidy played only a limited role in the "jumbo complaint" lodged by eleven countries in the WTO against the provision.[110] In particular, the panel dismissed Mexico's claim that the measure constitutes a specific subsidy on the procedural ground that Mexico had not argued that the CDSOA – which was the only measure at issue in the proceeding, rather than the disbursement made thereunder - "per se" explicitly

[109] See United States-Continued Dumping and Subsidy Offset Act of 2000 – Report of the Panel (16/9/2002). WT/DS217/R- WT/DS234/R, para. 4.245.
[110] The complainants were Australia, Brazil, Canada, Chile, the European Communities, India, Indonesia, Japan, Korea, Mexico and Thailand. There were also five third-party participants: Argentina, Costa Rica, Hong Kong, Israel and Norway.

limits access to offset payments to an enterprise, industry or group of enterprises or industries.[111] The panel also noted that Mexico had not succeeded in demonstrating that the CDSOA causes "adverse effects" within the meaning of Art. 5(b) of the SCM Agreement, because it had failed to prove either a "violation" or "non-violation" nullification or impairment of its rights under the WTO Agreement.[112]

However, the panel condemned the CDSOA as a non-allowable remedy to counter dumping and subsidisation practices. The claims of the parties and the rationale of the panel and of the Appellate Body related to the dispute on the Antidumping Act of 1916 ("US – 1916 Act"), which provided for criminal penalties and private damage actions against persons importing any articles at a price higher than the market value of such articles in the country of their production.[113] In particular, in "US – Antidumping Act of 1916" the AB held in the first place that according to Art. 18.1 of the Antidumping Agreement any "specific measure" dealing with dumping can only be applied in conformity with Art. VI:2 of GATT 1994 as interpreted by the Antidumping Code and, consequently, in accordance with the procedure established by that Agreement. Secondly, it noted that the penalties and damages provided by the 1916 Act were specifically aimed at countering dumping. It concluded, therefore, that since Art. 18.1 of the Antidumping Agreement makes antidumping duties, applied in conformity with GATT Art. VI:2, the only antidumping remedy permitted under

[111] WT/DS217/R- WT/DS234/R, para.7.115

[112] WT/DS217/R- WT/DS234/, para.7.132.

[113] See Meredith Schutzman, "Antidumping and Continued Dumping and Subsidy Offset Act of 2000. A Renewed Debate", *Cardozo J. Int'l & Comp. L.*, 11 (2004) p. 1072. web.lexis-nexis.com/professional.

WTO law, the alternative measures under the US statute of 1916 were inconsistent both with GATT Art.VI. and with the Antidumping Agreement.[114]

Relying on these premises, and extending them to the SCM Agreement, the Panel concluded that the CDSOA is a non-permissible specific action against dumping and a subsidy, contrary to ADA Article 18.1 and SCMA Article 32.1,[115] and, therefore, also in violation of paragraphs 2 and 3 of Article VI of GATT 1994.[116] The panel also held that by requiring support for the petition as a prerequisite for receiving offset payments, the CDSOA in effect mandates domestic producers to support the application and consequently frustrates the purpose of AD Article 5.4 and SCM Article 11.4, which is to limit the initiation of investigations to those instances where the domestic industry has a genuine interest in the adoption of anti-dumping and countervail measures.[117]

The panel, therefore, suggested that the United States should bring the CDSOA into conformity with its obligation under the AD Agreement, the SCM Agreement and GATT 1994 by repealing the Act.[118]

The Appellate Body, affirming the panel's opinion that the CDSOA is a non-permissible specific action under ADA article 18.1 and SCMA Art. 32.1, started with the analysis of the expression "impermissible specific action against dumping or a subsidy," developing a three-pronged standard, which focused on "specific action", "adverse bearing", and "permissibility".[119]

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[114] United States – Antidumping Act of 1916 – AB 200-5 – Report of the Appellate Body(28/8/2000). WT/DS 136/AB-R – WT/DS162/AB-R , paras.120-126 and para. 136.

[115] Art. 18.1 of the Antidumping Agreement provides: "No specific action against dumping on exports from another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement".
Art. 32.1 of the SCM Agreement provides: "No specific action against subsidy on exports from another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement".

[116] WT/DS217/R- WT/DS234/, para.7.51.

[117] Ibid., para.7.65.

[118] Ibid., para.8.6.

[119] Claire Hervey, "The Byrd Amendment Battle: American Trade Policy and the WTO". *Hastings Int'l & Comp. L. Rev.*, 27 (2003) p. 139

The Appellate Body defined specific action as a measure taken only in situations presenting the specific character of dumping or a subsidy.[120] It held, however, that, in contrast with the US opinion, this criterion does not imply that the measure must explicitly refer to the constituent elements of dumping or subsidy, nor does it rely on whether dumping and subsidisation trigger the application of the measure. What is relevant is the correlation between the measure and the elements of dumping or subsidy, which, therefore, are the necessary conditions for the countering action.[121]

As regards the second test, i.e. adverse bearing, the Appellate Body rejected the US contention that the term "against dumping or subsidy" in articles 18.1 of the ADA and 32.1 of the SCMA implies that the antidumping and CVD measures must operate directly on imported goods. Such interpretation would have left the CDSOA outside the remit of the antidumping and countervailing duty provisions, as the provision is not concerned with imported goods but with duty revenue distribution. The Appellate Body held that articles 18.1 and 32.1 refer to measures that act against dumping and subsidisation as such and are not confined to tariff measures against dumped or subsidised products. Indeed, the offset payments are financed from duties paid by foreign producers; they are received by domestic producers who compete with the foreign exporter, and improve the competitive edge of the domestic producer by being invested in qualifying expenditures related to the production of competing products.[122]

Having determined that the CDSOA is a specific action against dumping or subsidisation, the Appellate Body focused on its permissibility under the Antidumping Code, the SCM Agreement and Art VI of GATT 1994. Relying on

[120] United States - Continued Dumping and Subsidy Offset Act of 2000- AB 2002-7 Report of the Appellate Body (16/1/2003). WT/DS217/AB/R-WT/DS234/AB/R, para. 242
[121] Ibid., para. 244
[122] ibid., paras 247-255.

the rationale of US – 1916 Antidumping Act, the AB held that the CDSOA cannot figure among the permissible responses to dumping, which only include antidumping duties, provisional measures and price undertaking.[123]

The US contended, however, that because the decision on the Antidumping Act of 1916 only refers to dumping and, given certain textual differences between the Agreements, the antidumping rationale should not be extended to measures against subsidisation.[124] The Appellate Body objected that the structure and terminology of SCMA Art. 32.1 is identical with Art. 18.1 of the Antidumping Code except for the reference to subsidy. Therefore, as with antidumping, WTO countervailing rules do not provide an open-ended response against subsiding practices, but under Art VI:3 of GATT 1994 and the SCM Agreement allow only four kinds of responses to countervailable subsidies: definitive countervailing duties, provisional measures, price undertaking and multilaterally sanctioned countermeasures under the Dispute Settlement system[125] In short, as regards responses to subsidisation, according to the AB, the Byrd Amendment is definitely a countervailing measure, which, however, is not countenanced by WTO rules.

On the other hand, the Appellate Body rejected the panel's conclusion that the Byrd Amendment constitutes an action against dumping or subsidization because of the incentives that it creates for domestic producers, noting that WTO rules allow domestic firms to petition their governments for relief from unfair trade practices, and a measure could not be considered against dumping or a subsidy simply because it facilitates or induces the exercise of rights that are WTO-consistent.[126]

[123] Ibid., paras 263-265.
[124] Ibid., para.267.
[125] Ibid., para. 268
[126] Ibid., para. 283.

In the spring of 2003, the United States and the complaining parties entered into WTO arbitration regarding the timetable and form of implementation of the ruling. The parties disagreed on what constituted a reasonable period of time for implementation: the United States sought a fifteen-month period, whereas the complainants sought a six-month time period, dating from the decision of the Appellate Body on January 27th. 2003. The complaining parties argued that "prompt compliance" was required under the DSU, and that delay of implementation beyond the end of the U.S. fiscal year (September 30th. 2003) would irreparably harm the parties because annual disbursements are scheduled to occur within 60 days of the end of the fiscal year. The parties also disagreed as to whether full repeal of the Byrd Amendment, or just an amendment to its offset distribution section was required. The arbitrator ruled that the form of compliance was up to the United States, but no matter its form - repeal or modification - compliance was to be made by December 27th. 2003.[127]

In 2003, an American commentator argued that compliance was very unlikely, as roughly two-thirds of the Senate responded to the Appellate Body's ruling by signing a letter voicing support for the Byrd Amendment, and that, although President Bush had called for the repeal of the measure, he was unlikely to force the matter as the Amendment enjoyed substantial support in steel-producing states, whose vote was crucial in the elections of 2004. Besides, since the Byrd Amendment merely re-routed duties already collected by the U.S. Customs, its repeal would not directly lower prices on imports and consequently there were weaker incentives, in this particular instance, for domestic constituencies to lobby for compliance with the WTO's ruling.[128]

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[127] United States - Continued Dumping and Subsidy Offset Act of 2000 – Arbitration under Article 21.3(c ) of the Understanding on Rules and procedures Governing the Settlement of Disputes. Award of the Arbitrator (13/6/2003). Wt/DS217/14 – WT/DS234/22, paras. 50, 83.
[128] See Mark I. Movsesian, "International" op.cit., p. 154.

Nor did the US courts take particular note of the WTO rulings, probably also because the precision and unequivocal tenor of the incriminated statute leaves little room for a construction of the text in accordance with international rules. In March 2003 the Court for Appeals of the Federal Circuit, affirmed a decision of the Court of International Trade that had, correctly, rejected the contention of a Chinese exporter that the Byrd Amendment fundamentally alters the antidumping law into a statute imposing a penalty by directing payment of antidumping duties to the domestic industry. The Federal Circuit, however, in its rationale pointed out that the Amendment "far from rendering the antidumping statute penal in nature... actually enhances its remedial nature", also noting that "congressional findings supporting the Amendment underscore the statute's continued focus on assisting domestic producers and levelling competitive conditions through the negation of the unfair advantage gained by the price difference of the imported products".[129] It is extremely difficult not to find such a statement quite out of line with the perspective of the DSB.

As expected, the majority of the complainants, among which Japan and the European Communities, requested authorization, under Article 22.7 of the DSU to suspend the application to the United States of tariff concessions and related obligations under GATT 1994, in the form of the imposition of additional import duties on products originating in the United States, at a level not exceeding every year a percentage (in many cases up to 72%) of the amount of CDSOA disbursements relating to anti-dumping or countervailing duties.

It was foreseeable that sooner or later the provision was going to be repealed, and that this would be greeted as a further accomplishment of the new Dispute Settlement regime. Indeed, in February 2006 the US delegation reported

[129] Huaiyin Foreign Trade Corp. v. United States, 322 F.3d 1369, 1380-81, 2003, web.lexis-lexis.com/professional/.

that the US Congress had "approved the Deficit Reduction Omnibus Reconciliation Act, which includes a provision that repeals the CDSOA." and that the Act would promptly be signed into law by the President.[130] The other parties in the dispute, though welcoming the announcement as step taken by Congress towards the actual repeal of the CDSOA, disagreed that the new statute had brought its measures fully into conformity with the DSB' recommendations and rulings and, therefore, went on suspending their concessions.

It is also uncertain whether the Byrd Amendment has had a significant impact on the ever-widening trade deficit of the United States. Yet, there is one historical certainty: the scheme, which results in a patent violation of the multilateral CD and antidumping regimes, and entails a form of subsidisation, was introduced when the US economy was looking for a soft landing after seven years of good performance; it was still there when a recession followed; it did not quit the stage when a robust recovery, accompanied by a growing fiscal and trade deficit, took over, while most US trading partners still struggled to get their economies on track; and it is arguable that it was not fully repealed when the recovery finally spread to the US trade partners. In short, if the introduction of the Byrd Amendment contravened the SCMA and the Antidumping Code, together with GATT 1994, its claimed repeal, which has failed to convince the other parties, is far from the "reasonable period" criterion on which the main DSU remedy – officially, the only true remedy – rests.

## Conclusion

The picture provided by the foregoing is not entirely negative but overall is far from being encouraging. Certainly, WTO panels and the Appellate Body have

[130] United States – Continued Dumping and Subsidy Offset Act of 2000. Status Report by the United States- Addendum (7/2/2006). WT/DS217/16.dd.24.

often been extremely severe in respect of single measures and specific aspects of US administrative practice. However, with the conspicuous exception of the "Byrd Amendment" case the tendency, one could even say the policy, of the Appellate Body has been to uphold the US statute as much as possible.

In "Corrosion resistant carbon steel from Germany" the Appellate Body held that the SCMA does not prevent the strict construction of the "de minimis" rule advocated by the SAA, as the "de minimis" standard does not extend to sunset reviews. Therefore, both the US statute and its implementation in CVD investigations were legitimate. The practical results, however, are quite odd. Indeed, the sunset review, which should prove the exceptional need for further application of countervailing measures, ends up allowing a standard that could be less favourable to the foreign exporter subjected to countervailing duties than the standard in the initial investigation.

In "US-DRAMs" the Appellate Body has endorsed the rather wide US perspective on what constitutes entrustment or direction of private bodies by governmental authorities. The approach upheld by the AB will allow investigating authorities to countervail allegedly interventionist practices involving the private sector, even though there is no evidence of any explicit and affirmative governmental action imposing any particular duty. The question is going to be where to draw the line.

The privatization cases are more complex, also because they encompass the examination of the measure concerned from the US statute angle, but have similar characteristics. In this instance the DSB and the US courts have censured the methodology applied by the Department of Commerce to ascertain the pass-through of previously bestowed subsidies. However, the administrative practice stems from the construction of the US statute by the SAA and the US trade courts.

It is almost paradoxical that if the harassment of unfortunate non-subsidised foreign companies is finally going to end, this will be more the result of a new stricter construction of section 771 (5)(F) by the Federal Circuit than by the action of the DSB in defence of the multilateral regime. Nevertheless, it is ten years since the controversial section sailed through Congress. It is likely that in the course of this period many non-subsidised private-owned companies have sustained tariff barriers they should not have borne, not to mention the legal expenditures they incurred to fight their battle in US trade courts. The series of US "change-in-ownership" methodologies has its root in a faulty interpretation of the US statute that the Appellate Body has failed to counter. These "methodologies" have facilitated the imposition of extra duties on competitors that threaten US domestic industry in structural difficulties. All the cases involving EU firms concerned the steel sector. It is very likely that without the help of CVD affirmative determinations the US would have resorted to safeguard measures somewhat earlier than 2002; and, as we know, safeguard proceedings are more visible, politically contentious even within the country that applies them, and attract a much swifter reaction from trading partners as further proved in 2002-2003 by the "US – definitive safeguard measures" case. Thus, the privatization cases are a reminder that countervailing duty law can easily turn into a protectionist instrument. Even more so if one does not forget that the United States claims to be the champion of privatization all over the world.

We see the same results, but under different circumstances, in the Byrd Amendment dispute. In this case the panel and the Appellate Body have condemned the scheme voted by US Congress, but the US lawmakers have paid only a tardy attention to the decision of the DSB and to the appeals of their own President, actually passing the buck to their trading partners worldwide, who were thus compelled to decide whether to impose "suspension of concession", that is, higher duties on American products or to take care of domestic consumers. It seems, therefore, that when it is a question of measures that are of particular interest for economic groups on the support of which lawmakers are dependent along with the executive, full implementation of DSB's recommendations, within a reasonable period of time, turns out to be rather an idealistic remedy. On the other hand, agreement on compensation is often impracticable, and the imposition of tariff sanctions can be counterproductive for the countries that have recourse to it, and, in every case, is trade distorting.

If the Byrd Amendment and the "change-in ownership" methodologies are protectionist in intent and effects, looking at them as a whole we find this scenario: private-owned firms that have never received a "cent" from the public purse are subjected to extra duties simply because they have taken over subsidised publicly- owned companies; and to add insult to injury the "booty" collected by the US Treasury is promptly passed on to their US competitors. Certainly, not the best of both worlds.

# CHAPTER VIII

## THE DOHA ROUND NEGOTIATIONS: NEGOTIATING ISSUES AND THE STANCE OF THE PARTIES

### 1) An overview of the Doha Round negotiations on subsidies and countervailing measures.

Though more than five years have passed since the opening of the Doha Round, for an outsider it is too early to guess what is going to be the compromise subsidy and CVD text that will be agreed upon by the WTO members. Instead, the analysis of the proposals tabled by the parties to the negotiation has a historical value as a way to know the state of art of the still unresolved questions over the regime, most of which date back to the period preceding the signature of the Marrakesh Agreement.

The Doha Ministerial Declaration of November 14th. 2001 states that the aim of the negotiations on Anti-Dumping and Subsidies and Countervailing Measures agreements is "to clarify and improve disciplines while preserving the basic concepts, principles and effectiveness of these agreements, while taking into account the needs of developing and least-developed participants". The text is a carefully drafted compromise between those members who want to preserve the regime and those who want to transform it. However, as regards subsidies and CV measures the question remains whether in the course of the negotiations the pendulum would swing towards improvement and clarification of countervailing rules, thus putting into question the success laboriously achieved by the United States during the Tokyo and Uruguay Rounds, or towards a wider and more stringent discipline of government practices impending on the free play of the market, which was the long proclaimed goal of the United States.[1]

The former outcome was considered by US lawmakers as a threat to be strongly resisted, the latter as an opportunity to be eagerly pursued. The mandate of the Trade Act of 2002, by which Congress granted "trade promotion authority" to the Executive states unequivocally: "The principal negotiating objectives of the United States with respect to trade remedy law are - (A) to preserve the ability of the United States to enforce rigorously its trade laws, including the antidumping, countervailing duty, and safeguard laws, and avoid agreements that lessen the effectiveness of domestic and international discipline of unfair trade and (B) to address and remedy market distortions that lead to dumping and subsidization"[2]. Thus, in its communication on "basic concepts and principles of trade remedy rules", the United States argued that the mandate of the Doha Ministerial was that WTO members should focus on preserving the fundamental principles of existing trade remedy rules and ensure that they remain effective in addressing the problem of unfair trade. At the same time the US claimed that the Doha Declaration called for enhanced discipline of trade distorting practices as the root cause of unfair trade.[3] Therefore, according to the United States, not only is the Doha mandate far from allowing any weakening of existing trade remedy rules, but it also calls for the strengthening of the discipline of trade-distorting government policies.

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[1] The subsidy negotiations comprise three subcategories - general subsidy discipline, rules for countervailing measures and a sector specific discussion of environmentally harmful fishery subsidies, which is not covered by this outline.

[2] U.S. Code Congressional and Administrative News. 107th Congress – Second Session – 2002. Trade Act of 2002 (P.L. 107-210), sec. 2102 (14).

[3] Negotiating Group on Rules . Basic Concepts and Principles of the Trade Remedy Rules - Communication from the United States (TN/RL/W/27 – 22 October 2002).

The proposals put forward by the other WTO members can be divided into two categories: those that like the United States aim at expanding the scope of the subsidy regime, and those that aim at limiting the advantage for the complainant both in WTO disputes and in countervailing proceedings either by closing some loopholes in the basic concepts, or by securing some exemptions with regard either to certain groups of countries or certain kinds of subsidies, or by rendering less easy the initiation of a countervailing duty investigation. Thus, although up to December 2005 progress in the debate on subsidies and CV measures has been much slower than in the antidumping field and, as noted by the Hong Kong Ministerial Declaration, there is still "a need to deepen the analysis on the basis of specific textual proposals", four main areas of interest for the parties to the negotiations can be singled out.[4] Within these broad areas, as one would expect, most of the proposals focus on the contentious issues we have examined in the previous chapters.

***1) Definition of subsidy and specificity***

a) indirect subsidisation

In a subsequent communication on "subsidy disciplines requiring clarification and improvement" the United States has focused on "those distorting practices that take the form of indirect subsidies to specific companies or industries in which governments act through government- owned, government-controlled or government-directed private entities to provide financial support, which would either not be available from the private sector or would not be available on the same terms".[5] In this context the United States considers it

[4] See Doha Work Programme. Ministerial Declaration Adopted on 18 December 2005 – Annex D p.7. www.wto.org/english/thewto_e/minist_e/min05_e/final_text_e.htm

[5] Negotiating Group on Rules. Subsidies Disciplines Requiring Clarification and Improvement - Communication from the United States (TN/RL/W/78.- 19th. March 2003).

necessary to clarify the "entrust or direct" provision of SCMA Art. 1.1(A)(1)(iv) in those cases where government action, though not explicitly documented, can very much influence the course of the event by which a company or an industry obtains an advantage.

The United States has found an ally in the European Communities, which argues that the terms of the current Agreement make it extremely difficult to act against entities which may be providing the subsidy "under the covert direction of governments (e.g. the granting of loans and other financial support through financial institutions which are acting on non-commercial terms)". The European Communities acknowledges that current WTO rules can be construed only to cover such actions if there is a clear and unambiguous showing of "direction" by the government, which is often very difficult to prove. Thus it suggests that to prevent circumvention of subsidy discipline, article 1 of the SCM Agreement be amended to cover those entities which are effectively controlled by the state and acting on non-commercial terms, or to cover situations where the public direction is less apparent but nevertheless led to non-commercial behaviour in terms of the financial operations in question.[6]

It is easy to guess that the "improvement" of the text of SCMA Art. 1 sought by the United States and the European Communities was especially motivated by certain practices of Korean financial institutions (reported in Chapter VII) that, on government "encouragement", were providing financial support to an "uncreditworthy" group of companies engaged in the highly competitive semiconductor market, and which were already undergoing countervailing duty investigations.

[6] Negotiating Group on Rules. WTO Negotiations Concerning the WTO Agreements on Subsidies and Countervailing Measures - Proposal by the European Communities (TN/RL/W/30 – 21st. November 2002).

At the other end of the spectrum, Canada has argued for the need for stricter rules in the assessment of indirect subsidisation with specific regard to pass-through, when the recipient of a financial contribution and the recipient of the resulting benefit are different entities. Canada suggests that, in keeping with WTO jurisprudence, the reformed text of the SCM Agreement should clarify that an investigating authority cannot assume that the benefit of subsidies provided to producers of upstream input products passes-through to producers of downstream products, especially if there is recorded evidence that the transactions occurred at arms-length, but must establish, according to guidelines agreed upon by the WTO members, whether, and to what extent, upstream subsidies benefited downstream producers.[7] Once again at the basis of the proposal there is a controversy: the softwood lumber case.

b) specificity

As regards specificity, Canada remarks that the SCMA does not provide clear guidance on the meaning of enterprise and industry, nor on how the respective groupings are circumscribed. It, therefore, suggests that Art. 2.4 of the SCM Agreement be amended by providing that any determination of specificity must be in accordance with international standard industrial classification.[8] Secondly, Canada suggests that the weight of the "de facto" specificity factors in Art. 2.1 ( c ) of the SCMA (i.e., use of subsidy programmes by a limited number of enterprises, predominant use of the programme by certain enterprises, disproportionate amount of subsidies to certain enterprises and exercise of discretion) be made more explicit. According to Canada the amended article

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[7] Negotiating Group on Rules. Improved Disciplines under the Agreement on Subsidies and Countervailing Measures - Communication from Canada ( TN/RL/W/112 -6th. June 2003).
[8] Negotiating Group on Rules. Specificity.- Communication from Canada (TN/RL/GEN/6 – 14th. July 2004).

should clearly state that the factors in question must be evaluated based on the totality of the facts, avoiding giving decisive guidance to one or several of them.[9]

c) capital infusion

Another US suggestion, which, however, has not found a great response among the other negotiating parties, concerns the direct transfer of funds. With respect to the provision of equity capital, the United States submits that the standard set forth in article 14(a) of the SCMA needs "clarification".[10] According to the US, while the benchmark provided by the mentioned article is the consistency of government provision of equity capital with usual investment practices of private investors in the territory of WTO members, the real question in assessing the benefit should be whether governments should be investing and if so under what circumstances. In the US view, while government investments could be allowed in "lesser developed" countries, given the weakness of their capital market, there can be no such justification for developed countries. For the latter, therefore, if the marketplace in the country of investment determines that the company will not generate a "sufficient return", investment should only be allowed subject to stringent requirements, such as prior notification to the WTO Subsidies Committee, by which the capital providing government explains the consistency of its decision with the practices of private investors. In other terms, what the US is suggesting is the acceptance of its approach in countervailing duty investigations by the trade Community, bolstered, this time, by a set of obligations towards a WTO body.

In a subsequent communication the United states also suggests that equity infusions, including debt-to-equity conversions, be included in an expanded

[99] TN/RL/W/78.- 19th. March 2003.

category of prohibited subsidies, under the assumption that governments are positioned to ignore normal private sector profit-maximisation imperatives and to pursue governmental priorities irrespective of market signals, except if the government concerned in describing the terms of the transaction in its notification shows that the investment is consistent with the usual practice of private investors.[11]

The US proposal clearly shift the burden of proof onto the government accused of subsidising, whereas the present wordings of SCMA Art. 14 with regard to countervailing proceedings goes on the opposite direction by providing that the investigating authority cannot consider government provision of equity capital as conferring a benefit, unless the investment decision can be regarded as inconsistent with the usual investment practice in the territory in which it takes place. On the other hand, the communication is also an implicit admission of the doubts of the United States over the consistency of its approach in CVD investigations on equity infusion with the present multilateral regime.

***2 )Prohibited and actionable subsidies***

a) New discipline for prohibited and dark amber subsidies

As regards prohibited subsidies, the United States tries to extend the scope of the SCM Agreement by turning a tactical failure into a strategic success. As noted in chapter IV, the creation, under SCMA Art. 6.1, of a "dark amber" category of subsidies that entail rebuttable presumption of serious prejudice was the trade off for recognition by the US of non-actionable subsidies under Art. 8 of the Agreement. Both provisions lapsed in December 1999. The United States

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[10] Ibid.

[11] Negotiating Group on Rules. Paper from the United States Expanding the Prohibited "RedLight" Subsidy Category. TN/RLGEN94 (16 January 2006).

suggests that the existing category of prohibited subsidies be expanded to include those instances of government intervention that have a similarly distorting impact on competitiveness and trade. Among them the proposal lists the main hypotheses of "dark amber" subsidies, such as large domestic subsidies, subsidies to cover operating losses, and direct forgiveness of debt. In short, the United States aims to achieve the long pursued goal of extending the ban on subsidies to domestic subsidisation, or at least some of its forms.

The European Communities has joined the United States in calling for an expansion of the prohibited subsidy category to tackle effectively the multiplication of government practice that, according to the EC, favour domestic industries.[12] In particular, the EC proposal focuses on those measures that make available to domestic users some important inputs at a price substantially lower than the international market price and on those subsidies that, although falling outside the purview of the present text of SCMA Article 3.1(b) referring only to subsidies contingent upon the use of domestic over imported goods, notwithstanding their inconsistency with the National treatment requirement under Art. III of GATT 1994. The EC proposal also requires the prohibition of government financing on terms inadequate to cover the long-term operating costs of the loan when such measures benefit exported goods.

b) Serious prejudice

The United States, though recognising that one of the major subsidy discipline advancements of the Uruguay Round is clarification of what constitutes serious prejudice, argues that such a remedy needs to be further strengthened. In particular, the US submits that rather than looking for the

[12] Negotiating Group on Rules. Subsidies – Submission of the European Communities.TN/RL/GEN135 (24 April 2006)

elimination of adverse effect the amended agreement should directly provide for the repeal of the subsidising measure, thus equating its treatment to that of prohibited subsidies. [13]

Canada joins the United States in calling for a strengthening of the serious prejudice discipline. Canada, however, suggests that the lapsed dark amber category in Art. 6.1 of the SCMA be reinstated and that the cost-to government approach prescribed in Annex IV to the Agreement for calculation of the ad valorem subsidisation under Art. 6.1 be replaced with the benefit-to-the recipient methodology.[14]

c) export subsidies

On the other hand, both Australia and Canada consider that there is a lack of clarity in the rules relating to the prohibited subsidies contingent "in fact" upon export performance and, therefore, more objective and verifiable criteria are needed on the question of conditions or facts which give grounds for a conclusion of export contingency.[15] In particular, the proposals argue that, as pointed out by WTO case law, it is not sufficient to demonstrate solely that a government anticipated that exports would result but that the government granted the subsidy contingent upon export performance; the mere knowledge that a recipient's sales are export-oriented does not demonstrate, in the absence of other factors, that the granting of a subsidy is tied to actual or anticipated exports; export orientation

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[13] TN/RL/W/78.- 19th. March 2003

[14] TN/RL/W/112 – 6th. June 2003.
Negotiating Group on Rules. Serious prejudice – Communication from Canada (TN/RL/GEN/14 – 15th. September 2004).

[15] Negotiating Group on Rules. Further Contribution to the Discussion of the Negotiating Group on Rules on the Agreement on Subsidies and Countervailing Measures - Submission from Australia (TN/RL/W/139 – 18th. July 2003).
Negotiating Group on Rules. Prohibited Export Subsidies - Communication from Australia (TN/RL/GEN/22 – 19th. October 2004).
Negotiating Group on Rules. Improved Disciplines under the Agreement on Subsidies and Countervailing Measures and the Antidumping Agreement - Communication from Canada (TN/RL/W/1 – 15. April 2002)

may be taken into account as a relevant fact provided that it is one of several facts and not the only fact supporting a finding. These elements, however, are not explicitly set forth in the text of Art. 3 and footnote 4 of the SCMA. The communications also contend that the present rules relating to prohibited subsides are discriminatory in favour of large economies, as a subsidy provided to a product by a WTO Member with a large domestic market for that product may be actionable but carries little risk of being found to be export contingent, whereas the same subsidy provided by a country with a relatively small domestic market is likely to be found contingent on export performance given a much higher export orientation imposed by the size of the market. To overcome these shortcomings the proposals call for better guidance in the SCMA text on what kinds of facts must be taken into account in determining export contingency, while making it clear that export propensity should not be a factor taken in isolation. Here too one can easily detect that the proponents had some disputes in mind, such as Australian automobiles, where most of the subsidised output was destined to be exported given the limited scope of the domestic market.

d) export credits and guarantees

A specific aspect of the discipline of export subsidy is the subject of a communication from Brazil, which is one of the protagonists in the long-lasting dispute on international aircraft bids assisted by robust public financial support and export credit in particular.[16] Brazil, calling for a reform of the present discipline based on greater flexibility, contends that the current rules that concern the granting of export credits and guarantees (i.e., items (j) and (k) in Annex I to the SCMA illustrative list of export subsidies) derive from provisions that were first introduced in the sixties, and thus refer to outdated benchmarks that put

[16] Negotiating Group on Rules, Export Credits in the WTO - Paper by Brazil (TN RL W 5 – 26 April 2002)

developing countries at a disadvantage.[17] In particular, as regards item (k) on export credits Brazil argues that the general rule that Members must not finance exports at rates below their cost of funds, except if they do not secure a "material advantage" is a source of inequity as the costs of funds of WTO Members are different and should not be a parameter for determining compliance with export subsidy discipline. On the other hand, the safe harbour accorded to the OECD Arrangement on export credits favours members of the Paris Organization and introduces asymmetries in the capacity of WTO members to compete on an equal footing in the field of export credits.

Analogous difficulties apply to the "break even" requirement in item (j), which bans the provision of premium rates that are not adequate to cover long-term costs and losses for the insurance company. In Brazil's view, this provision could be interpreted as allowing WTO members to offer guarantees that bring transaction rates under usual market levels, thus penalising developing countries that cannot match these terms, even if they offered similar guarantees. Consequently, as sovereign credit ratings differ considerably even among homogeneous economies, in a membership so diverse as that of the WTO, the "break even" requirement of item (j) falls quite short of ensuring a level playing field among Members, with a clear disadvantage to those that enjoy lower credit ratings.

In contrast, the European Communities, while taking note of the concerns of developing countries that are not members of the OECD, not only suggests that a revision of items (j) and (k) should not prejudice existing rules, but argues that the Arrangement on Official Support for Export Credits should not be applied only to interest rates but could be used as a benchmark for all forms of export financing under the SCM Agreement.[18]

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[17] See Chapt. IV, p. 141.
[18] TN/RL/W/30 – 21st. November 2002.

e) discipline of direct and indirect taxes for subsidies and CVD purposes

In its March 2003 communication, the United States recognises that the GATT/WTO subsidy rules have historically disciplined direct and indirect taxes differently and that under the existing Agreement there is greater likelihood for direct tax concessions related to export activities to be found to be an export subsidy. The US, however, argues that the current distinction ignores the potential trade-distorting effect of some practices involving indirect taxes and calls, therefore, for greater equalization in the treatment of various tax systems.

As one should expect, the other parties to the Doha talks have carefully avoided showing any sort of reaction to the stone thrown by the US delegation.

*3) Differential treatment for developing countries*

As expected, proposals aimed at some exceptions from the current rules on subsidies have been put forward by numerous developing countries.[19] The developing members point out that subsidisation in general is necessary to secure development objectives and, in particular, subsidies contingent upon the use of domestic over imported goods are crucial to the process of industrialization and development and any prohibition on such use would further disadvantage these countries. India claims that the prohibition on export subsidies should not apply to subsidies granted by developing countries where they account for less than 5 per cent of the f.o.b. value of the product. Likewise, all developing countries should be exempted from the prohibition on import substitution subsidies. Venezuela

[19] Negotiating Group on Rules. Agreement on Subsidies and Countervailing Measures/Antidumping Agreement - Submission by India (TN/RL/W4-25th. April 2002).
Negotiating Group on Rules. Egyptian Paper Containing Questions and Comments on the Contributions Submitted in the Framework of the Doha Negotiations on the Subsidies and Countervailing Measures Agreement. (TN/RL/W/57 – 10th. February 2003).
Negotiating Group on Rules. Proposals by Venezuela and Cuba on Improved Rules under the Agreement on Subsidies and Countervailing Measures- Non Actionable Subsidies - (TN/RL/W/41-10 December 2002).

submits that the bestowal of subsidies by developing country members should be considered in the context of the reintroduction of the green light category.

The industrial countries obviously take quite a different view. In particular the European Communities calls for stricter and more operational rules on exports contingent upon use of domestic over imported goods, with no exemption for any WTO member. Specifically, the European Communities contends that the present rules impose too high a threshold of proof on the complainant especially as regards "value-added requirements" as, in its opinion, under SCMA Art. 3.1(b) it is necessary not only to show that an import substitution programme exists, but also to explicitly demonstrate that, in order to obtain the subsidy, the actual use of domestic over imported goods is required on a case-by-case basis.[20]

*4) calls for a reform of the CVD regime*

Developing country members and industrialised ones, however, unite in calling for a thorough reform of the CVD regime, designed to protect foreign exporters against the interests of competitors in importing countries and to eliminate perceived bias in CVD investigation proceedings. Thus, the EC proposes higher initiation standards coupled with a swift control mechanism that should make the initiation of an investigation separately challengeable before the DSB.[21] Brazil points out that under current rules (Art. 11.4 of the SCMA) an application for countervailing proceedings can be filed with the support of those representing only a minority (25%) of the total domestic production of the like product in the importing country. It, therefore, suggests that the level of minimum

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[20] TN/RL/W/30 – 21st. November 2002.

[21] Negotiating Group on Rules. Negotiations on Antidumping and Subsidies – Reflection Paper of the European Communities on a Swift Control Mechanism for Initiation (TN/RL/W/67 – 8th. March 2003).

domestic support be brought to 50%.[22] Brazil, along with other newly-industrialised countries, stresses the need for a provision which clearly defines the scope of the product under investigation so as to prevent investigating authorities from grouping under a single heading products destined for different market segments under a single heading.[23] India, pointing out that the share of countervailing duty actions against developing countries is disproportionate to their weight in international trade, calls for the following amendments to Art. 27 of the SCM Agreement: 1) a 7% of total imports negligibility threshold under which developing countries' products should be excluded from CVD proceedings, 2) an increase of the "de minimis" level above the current 3% ad valorem, 3) the imposition of countervailing duties only to the amount by which the subsidy exceeds the "de minimis" level.[24] As regards countervailing duty reviews, Brazil remarks that the SCM Agreement does not provide guidance on the extension of requirements and methodologies applied to initial investigations, thus making it possible for the investigating authorities to apply methodologies that are not consistent.[25] Indeed, the validity of the Brazilian observations seem to be borne out by the "US-corrosion resistant carbon steel from Germany" decision on the non- applicability of the "de minimis" requirement" in sunset reviews. Brazil also calls for a mandatory "lesser duty" rule, under which the fully calculated amount of subsidisation would not be fully offset by CVD duties whenever the investigating authorities identify an "injury margin" lower than the subsidy margin.[26] In turn, the European Communities argue that the presumption in current rules towards expiry of CVD proceedings after 5 years is being

[22] Negotiating Group on Rules. Countervailing Measures: Illustrative Major Issues – Paper by Brazil (TN/RL/W/19 – 7th. October 2002)
[23] TN/RL/W/19 – 7th. October 2002. TN/RL/W/104 – 6th. May 2003.
[24] TN/RL/W/4 -25th. April 2002.
[25] TN/RL/W/19 – 7th. October 2002.
[26] Ibid.

circumvented by the initiation of unsubstantiated reviews, thus prolonging the life of measures and, therefore, claims that there is the need to spell out more clearly the requirements for extending the life of a measure for a further period.[27]

**Conclusion**

An American scholar has argued that most of the reform proposals tabled so far (in practice, the bulk of the proposals put forward by WTO members other than the United States) are "weakening" the effectiveness of the SCM trade regime and thus can be viewed as fostering trade distorting subsidisation.[28] Though the scholar has a point in noting that many of the proposals are motivated by specific policy interests or by being on the losing side in disputes decided under present SCM rules, his argument takes it for granted that all form of subsidies are actually or potentially trade distorting, which as noted above, is the official philosophy of the United States; he also takes it for granted that there are no niches for subsidisation that are not covered by the text of the present multilateral rules and that countervailing proceedings are immune from exploitation for protectionist ends.

At any rate, the alleged conflict between the hard-line stance of the United States and the attempt of the other parties to weaken the regime established by the Uruguay Round is not borne out by the negotiating proposals.

The United States, having entered unwillingly the negotiations on subsidies and countervailing measures within the Doha Round, has nevertheless exploited the opportunity offered by the talks to renew its Uruguay Round efforts to expand the number of prohibited subsidies, extending the ban to those

[27] TN/RL/W/30 – 21st, November 2002.

previously included in the no longer in force dark amber category. The United States also tries to obtain multilateral recognition of approaches long established in its CVD regime, such as those concerning equity infusion. But other developed countries, prominent among which is the European Communities, are also calling for the strengthening of the present subsidy regime and for the extension of its purview. Many industrial countries, however, also call for a clarification of some component parts of the subsidy definition in the SCM Agreement and of its export subsidy provisions. In any case, most parties to the Doha Round negotiations other than the United States call for a reform of the countervailing duty regime that could prevent the perceived bias in favour of domestic producers in the importing country.

It seems, however, that the Round has not yet produced unified groups of proposals and even less a compromise between the various proposals that could open the door of an agreement by creating a trade-off between competing interests. In particular, the United States has no interest in swapping a significant reform of the countervailing duty regime that could limit its room for manoeuvre, whether for protectionist goals or for the sincere search of a level playing field, with a more favourable regime for direct taxation benefits, whose achievement through negotiation has been thwarted by the unfavourable decisions of the Dispute Settlement Body. After all, making allowances for a successful conclusion f the Doha Round, no progress or limited results in the negotiations on subsidies and countervailing measures would not be viewed with deep disappointment by the United States as the main mandate for the US negotiators was the defence of the regime established by the previous round. On the other hand, subsidy/CVD talks are just part of the negotiations going on within the

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[28] John R. Magnus, World Trade Organization Subsidy Discipline: Is This the "Retrenchment

Negotiating Group on Rules along, among others, with antidumping talks. In the latter sector progress towards the reform of the present regime has been more rapid and could spill over in the contiguous negotiating area. In particular, the adoption of the "lesser duty" rule, which is presently debated in the antidumping negotiations, could significantly curb the possibility of exploiting countervailing measures for protectionist ends since any extra duty would be strictly correlated to the injury caused by the subsidised imports under investigation.

Round?", *J. W. T.* (2005) p. 990 et seq..

# CHAPTER IX

# CONCLUSIONS

The above analysis leads us to a final synthesis and some closing remarks.

In the introduction we noted that the interaction between the US regime and the multilateral rules on subsidies and countervailing measures can be divided into two strands: on the one hand, the specification of certain fundamental concepts of the multilateral regime and the regulation of specific sectors of particular interest for the US, such as taxation of exported products and export credit. On the other hand, the countervailing duty regime as a possible tool for protectionist ends. The point of contact is the definition of what constitutes a subsidy. This definition is of quite recent origin, being adopted by the SCM Agreement to establish an all encompassing benchmark. Yet, the difficulty of pinpointing the scope and nature of subsidy in economic analysis is no less challenging in the legal field. In final analysis many aspects of the definition of subsidy in the SCMA resulted from a compromise and were affected by it and bound to be subject to dispute. The United States prevailed in shaping the multilateral rules on subsidies but, in contrast to prevailing views, the victory was far from complete.

The United States achieved at least a potential victory when the Uruguay Round SCM Agreement accepted the American viewpoint that subsidies must be assessed with reference to the benefit for the recipient and that the benchmark for this assessment must be the market. The United States was also successful in extending the category of prohibited subsidies to those subsidies that are contingent on the use of domestic over imported goods and in definitively attracting domestic subsidies under multilateral regulation. Yet, in contrast with the US perspective, export and import substitution subsidies are not prohibited merely because they are bestowed on exported products or import substitute products. As confirmed by the Appellate Body in Canada Aircraft, the ban is conditional on a functional relationship between the grant of the subsidy and the destination of the product concerned. Likewise, certain domestic subsidies that the United States wanted to capture among the prohibited subsidies remain simply actionable. The main Achilles' heel of the US turned out to be the fiscal treatment of revenue from exports where the United States suffers from an initial handicap. Whereas the exemption or the remission of duties or taxes borne by like products destined for domestic consumption is "ope legis" deemed not to be a subsidy if the product is exported, no equivalent exemption or remission is granted on direct taxation of income originating from export activities. The initial handicap was exacerbated by the fact that the United States laid its income tax net beyond domestic borders catching, under Subart F of the Internal Revenue Code certain defined income of controlled foreign subsidiaries. The DISC regime was a failed attempt to overcome the obstacle by establishing an endless deferral of taxation of export income. But such an attempt did not escape the Illustrative List's provision, although its condemnation was for long neutralised by the concurrent conviction of the regime of some EC member states, deemed to have equivalent economic results.

The more complex FSC regime, at any rate, was more likely to escape the sanctions of the Illustrative List being based not on the open exemption or deferral of an income whose taxation was provided by the general rules, but on the establishment of an "apparently autonomous" regime conditional on the creation of a foreign corporation whose relationship with its US parent does not necessarily coincide, from a strictly legal angle, with that of a Subpart F subsidiary. It must be noted, however, that in the first stage of the WTO dispute the United States argued that the complexity of the underlying tax issue meant the matter should be discussed in other fora, i.e. in the Organization for Economic Cooperation and Development or in the competent authority process under the relevant bilateral tax treaties.[1] Besides, the Panel could resort to the binding opinion of the permanent group of experts under SCMA Art. 7 but preferred to rely on its own judgment, focusing its analysis on the relevant provisions of the SCMA but failing to address in sufficient depth the complex and often interwound rules of the American tax regime on foreign source income.

The US was more successful in protecting another sector of major interest for its export promotion policy from the general purview of subsidy regulation: government supported export credit. Here, together with the other OECD members and in particular the European Communities, the US secured a special regime for interest rates in line with the provisions of the Arrangement on guidelines for Officially Supported Export Credits, which otherwise were likely to be considered as prohibited export subsidies. The success is partially strengthened by the broad interpretation of the exception by the DSB, which encompasses those factors directly affecting the interest rate, such as the loan duration and the grace period for interest and principal repayment. Unsurprisingly, the privileged position actually given to OECD members is strongly resented by those developing countries like Brazil that have problems in obtaining funds in the international market at conditions comparable to those of their industrial competitors.

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[1] US-FSC, WT DS108R, 8.10.1999, para 7.12.

The scenario on the other side of the coin, the countervailing duty regime, is not less complex. The previous chapters provide no positive answer to the general question of whether the CVD regime is protectionist per se, at least if we respect the due process principle. Regarding the United States, as noted in the introduction, there can be factors that could tilt the balance towards a verdict of protectionism, such as the membership of the International Trade Commission and its voting system, the high cost of judicial proceedings before American trade courts, or the imposition of countervailing duties along with antidumping duties on the same products, which clearly seem aimed at providing defence for domestic industries losing ground against foreign competitors. But each of these factors could be a potential component part of the protectionist weaponry or the upshot of exogenous circumstances. They are not by themselves causal factors.

On the other hand, countervailing proceedings cannot claim to be the shining path to the optimal utilization of resources in the international market against distortions brought about by subsidizing measures or to the creation of a level playing field against unfair competition by subsidised products. Protectionism is a relative concept and its ascertainment must be treated comparatively. As regards countervailing measures, the essence of protectionism is the imposition of extra duties on exports that could avoid such burden or the imposition of a higher extra duty than that otherwise allowable. This quite often results from applying more severe parameters than other benchmarks that could also be legitimately applied. The choice of criteria could change according to the political environment and the business situation in the importing country. An early and conspicuous example is given by the specificity requirement developed in the US CVD regime as a first test to countervail foreign products. The specificity requirement was firstly adopted as a means to protect foreign exporters from the indiscriminate application of measures that could curtail their ability to have access to the US market. Very soon, however, the specificity test was applied more restrictively. The approach developed in the Cabot case led to evidence of specificity and, consequently, of subsidisation even where the prevalent usage of public financial contributions by a limited number of firms or industries was due to fortuitous factors and to the structure of the market.[2] Later on the Department of Commerce and the US trade courts relied on a case-by-case approach, which was adopted by the SCMA.[3] Another example can be found in the idea, supported by the US Congress when foreign competition started to bite in the 1980s, that subsidies bestowed on a firm necessarily pass-through, whether with regard to upstream subsidies, those provided on products used as inputs for exported goods increasing the competitive margin of the latter, or to subsidies bestowed on a corporation that is taken over by another firm.

The US CVD regime, whose main features were mostly developed in the aftermath of the Tokyo Round Agreement, relied on the following:

1) the submission to countervailing duty of subsidies not prevalently contingent on the export performance of a country but which still have an impact on it, that is, domestic subsidies.

2) The requirement of specificity to countervail foreign products benefiting by domestic subsidies.

3) The idea that the market must be the primary benchmark in assessing existence and amount of subsidisation.

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[2] See Chapt. III, sect. 2.
[3] Ibid.

The US pattern prevailed in establishing the key concepts of the SCM Agreement, both with reference to the general identification of subsidy in Art. 1 of the SCMA and in Part V of the Agreement. In particular, it is not the load on the budget that is taken into account in assessing occurrence and amount of the benefit. The benchmark is what private parties would pay and receive in the marketplace, or the provision of a more favourable fiscal and tariff regime to specific firms or industries. It does not necessarily follow that the acceptance of the American model by itself fostered protectionism. The bestowal of a benefit principle, measured with reference to ordinary market conditions, is perhaps more severe but certainly not more potentially biased than the charge to the budget principle. On the contrary, the latter does not give due relevance to the higher costs often borne by developing countries. We need only remember the higher cost of debt and funding in the international market for these WTO members.

Why then are the criteria endorsed by the SCMA often accused of protectionism and of having stimulated an upsurge in countervailing duty proceedings outside the United States?[4] The point is that the benchmarks adopted by the Agreement does not provide a precise parameter to ascertain existence and amount of the benefit. As shown in the previous chapters and repeated above, since the relevant articles of the SCMA have failed to provide any exact assessment method, states initiating CVD proceedings can take as parameter conditions that are harder to establish than others, thus making it possible to catch otherwise legitimate practices. In contrast, the charge to the budget criterion is not multifaceted and can be easily applied.

[4] Paul Waer and Edwin Vermulst, "EC Antisubsidy Law and Practice after the Uruguay Round. A Wolf in Sheep's Clothing", J.W.T., 33 (1999), p. 18.

With particular reference to the post Marrakesh US CVD regime room for protectionism can be found in the following administrative practice:

a) With regard to the provision of goods and services the US bases its investigations on the idea that only a market free from state interference in the exporting country can be taken as a benchmark, whereas it seems to ignore oligopolistic conditions and restrictive practices by private firms both in the exporting and in the importing country.

b) The United States follows quite a restrictive perspective in ascertaining the consistency of capital infusion into government-owned companies with the investment decision standard for ordinary private investors. According to the United States, the benchmark should be the choice made by external investors interested in short-term profitability. Rational choices of investors that already have a stake in the company are not taken into account. Therefore capital infusions that would be perfectly legitimate from a wider market perspective if decided by private investors, are viewed as a form of subsidisation if decided by the government and are, therefore, countervailable. Besides the sanction is unduly severe, as the total amount of the investment is considered a grant. The United States, having realised that its perspective does not necessarily fit the SCMA provisions, in the Doha Round negotiations asked for a clarification of Art. 14 of the Agreement, which should obviously uphold its point of view.

c) The Department of Commerce adopted a set of methodologies ("gamma" and "same company") which easily led to the conclusion that non-recurring subsidies, mostly bestowed on government-owned corporations, pass-through to those privately- owned companies that have the misfortune of taking over the former at fair market price.[5] This finding is not consistent with economic logic and, therefore, has protectionist effects. Each of these methodologies was found to be inconsistent both with the SCM Agreement and with the US statute. Yet, Commerce has promptly replaced each flawed methodology with another methodology that has the same economic result, and thus has been able to go on imposing CVD duties on companies that have received no benefit whatsoever.

d) During the brief period of effectiveness of SCMA Art. 8, the US administering authority, giving a formalistic interpretation to the requirement of Art. 8.2(b)(ii) and of the implementing provisions of the URAA, succeeded in considering as actionable measures aimed at promoting investments in areas that were disadvantaged. The protectionist bias of such an approach is even more striking if we take into account that the final text of Art. 2 of the SCM Agreement does not consider as specific, and therefore countervailable, subsidies that are bestowed directly by local authorities, with exactly the same goals and effects as those subject to countervailing duties when provided by central authorities.

e) The United States does not extend to sunset reviews the "de minimis" subsidy requirement to initiate a CVD investigation with the odd result that it can continue imposing countervailing duties on imported products, even though their subsidy content has fallen below the threshold required to initiate an investigation.

f) DOC allocates non recurring subsidies according to the average useful life (AUL) of the physical assets of the firm under investigation as set forth in the Internal Revenue Service Class Life Depreciation Range System, for fiscal purposes, thus imposing a methodology applicable to US industries to firms whose exports are often produced in very different industrial environments.

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[5] See Chapter VII

Only some of the above listed protectionism-biased US rules and administrative practices have till now undergone the scrutiny of the Dispute Settlement Body.

Given the ambiguity of many of the WTO rules with which the consistency of the American regime must be ascertained, the panels have given priority to the object of limiting as far as possible the room for manoeuvre in exploiting CVD proceedings for protectionist ends, often attacking both the administrative practice and statutory provisions of the countervailing country. The attitude of the Appellate Body, which often has overturned the panels' opinions, has been quite different. The AB has exploited the ambiguity of the multilateral rules on subsidies and countervailing measures, to engage in judicial activism, of which, in contrast to many other cases, it has openly recognized the political nature.[6] Considering itself confronted with the dilemma of whether to favour fight against subsidization or to counter use of countervailing measures for protectionist ends, it privileges the first goal, overlooking the fact that the latter can be as trade disruptive as the former. With the only, though relevant, exception of the "Byrd Amendment" case, the Appellate Body, while condemning the US administrative practice under review in several cases, refrains from condemning or even countenances the US statute implementing the SCM Agreement, as supplemented by the SAA and the 1998 Final Rule, which is at the root of the condemned administrative practice. Summing up what has been illustrated in Chapter VII, the Appellate Body has widened the administering authority's room for manoeuvre as follows:

[6] On the general attitude of the Appellate Body in a multilateral legal environment characterised by often recurring indeterminate provisions, see Sol Picciotto, "The WTO's Appellate Body: Legal Formalism as Legitimation of Global Governance", *Governance,* 18 (2005) n. 3

1) Going beyond the wording of Art 14 (d), it allows the replacement of the domestic market as a benchmark for assessing subsidization if it is abnormally affected by the dominant position of public authorities.

2) While recognising that the subsidy pass-through is eliminated in transactions between private parties at arm's length and fair price, it argues that the rule does not work when one of the parties involved in the negotiation is government controlled, since governments can alter the conditions of the sale together with the signals given by the market. Thus there is a double standard for private sales and for sales of government-owned firms, as for the latter the purchase could even take place, quite puzzlingly, at the fair market price, which, however, has the original sin of being established in a market whose conditions are distorted by the dominant position of the State. At least in countervailing proceedings the final judge of such an occurrence is the administering authority in the importing country.

3) By extending to the utmost the idea of entrustment and directive to private bodies in SCMA Art 1.1(a)(1)(iv), the AB has included among the financial contributions listed in the article financial support provided by private firms whose decision has somehow been conditioned by governmental authority. Obviously, this gives great leeway to national administering authorities in determining when private bodies act as proxy for the government.

4) Giving preference to a literal approach in interpreting the text of Art. 21 on sunset review, or more specifically in giving a meaning to an omission in the wording of the provision, the AB held that the " de minimis" requirement under Art 11.9 for the initiation of an investigation does not apply to sunset reviews. The decision of the Appellate Body is, perhaps, consistent with the text, as noted in Chapter VII, but the AB justifies its opinion politically, referring to the risk of

unduly altering the delicate balance of the negotiated SCM Agreement However, the Appellate Body fails to explain why the extension of a requirement, which is perfectly consistent with economic logic and probably with equity, should alter the delicate balance of the Agreement and in which way. The result is that WTO members can go on imposing extraduties after the five year time limit provided by Art. 21.3, although according to Art. 11.9 the initial investigation could not be started.

This research made it clear that it has no pretence at being normative and that its approach is simply positive. Even normative ambitions should indeed recognise that there is no simple answer and no single solution given the context of present multilateral rules, the impact of certain AB's opinions and the different attitudes of the parties concerned.

An obvious solution would be that WTO members should reassert their sovereign prerogatives in reshaping the SCM Agreement test and eliminating the ambiguities and loopholes characterising present rules. In so doing the members could trade off the reform of some measures in which they have a particular interest with the restructuring of other measures of greater interest for other parties in the negotiation. For instance, the United States could have an interest in trading an amendment of Art. 1.1(a)(1)(ii) on revenue foregoing with a more restrictive definition of private intervention in carrying out subsidising policy under Art. 1.1.(a)(1)(iv) or with an amendment of Art. 21.3 providing for "de minimis" requirement also in sunset reviews.

Unfortunately the modifications to be traded off are not uniform. In Art. 21.3 a simple supplement to the text could achieve the desired results. However, in cases like Art. 14(a) an amendment to the present text, requiring, as suggested by the United States, more specific criteria than the present reference to the usual investment practices in the exporting country with regard to capital infusion, could help strengthen protectionist biases. In other cases, such as Art. 14(d) on the provision of goods and services, the parties to the negotiation should agree when the criterion of the market conditions in the exporting country should be abandoned and which other terms of reference should be adopted. No easy task.

The ugly fact is that favourable chances for possible trade offs are few, because, as lamented by the Hong Kong Ministerial Declaration, the dialogue on subsidies (and countervailing measures) has made little progress, while disputes before the DSB have been going on. It is, therefore, more apposite and, perhaps, more interesting to stick to the positive approach and investigate which factors hinder the negotiating process for the rebalancing of the Agreement and what chances there are for substantial progress.

There are three main obstacles: the ambiguity of key articles in the present SCMA text; judicial activism, sometimes beyond the boundaries of the text, from the Appellate Body, encouraged and, to a certain extent, imposed by the mentioned ambiguities and the slow start of the negotiating process; the different weight of WTO members in the world economy and, therefore, their different ability to oppose or delay the implementation of the DSB's decisions. The interaction between these factors has rendered the need for serious bargaining less compelling.

The United States certainly has been foiled in its hopes to rebalance the disadvantages for export income inherent in its corporation tax regime especially vis-à-vis its EU trade partners and has failed in its attempt to transform the countervailing and antidumping regime in a new form of subsidization for its companies. And yet, due to its sway in international trade it has been able to turn a rapid phase-out of its measures condemned by the DSB in a long phase-down. The United States has dragged its feet for over five years on the FSC saga: the second DSU Art. 21.5 decision of the DSB was circulated in March 2006, while the first panel opinion dates back to 1999.[7] Likewise, in April 2007, that is seven years after the adoption of the Byrd Amendment, the European Communities was still notifying the imposition of extra duties on American products in retaliation for the delayed repeal of the Act.[8] On the other hand, the Appellate Body has found most US CVD "statutory" rules consistent with the SCMA and GATT 1994. This does not mean that many US administrative practices have been stricken down, but, as shown above, the underlying planks of the American regime have been upheld. There is, therefore, no need for the US to bargain multilateral rules referring to countervailing measures, which have not weakened the American regime, against some concession on the provisions for subsidy identification, prominent among which those on fiscal measures as financial contributions.

The other members seem unable or unwilling to establish a united front. This can be attributed to the fact that a growing number of them have become active users of countervailing proceedings to protect their industries against foreign competition, whether fair or unfair. Secondly their perspective on subsidies and some forms of them are quite different. India considers subsidies an essential tool to offset the disadvantage imposed by the market on developing countries. Brazil strongly criticises the safe harbour for export credits in line with the Arrangement on Officially Supported Export Credits as conferring an

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[7] United States- Tax Treatment for "Foreign Sales Corporations"..Appellate Body Report and Panel Report pursuant to Article 21.5 of the DSU.Action by the Dispute Settlement Body. WT/DS108/36. March 17, 2006.

[8] United States Continued Dumping and Subsidy Offsect Act. Communication from Japan. WT/DS217/50 of 24 August 2006
Communication from the European Communities. WT/DS217/51 of 24 April 2007).

unjustified advantage to the OECD industrial countries, but it is much more lenient with regard to its own export subsidising practices, viewed as necessary to overcome the constraints imposed by international financial markets on developing countries. The European Communities, within its borders, has adopted increasingly stringent policies on subsidisation from member states. Thirdly, in this context many proposals for reshaping subsidy rules are related to ongoing disputes rather than a wider perspective.

Members other than the US are more united in calling for a review of the multilateral CVD regime. Many proposals circulated in the Doha negotiations concern procedural improvements to guarantee that countervailing proceedings are introduced by firms actually representing the majority of domestic production or aimed at introducing multilateral early monitoring mechanism over the initiation of CVD investigations. Others address some of the issues above listed, such as the extension of the "de minimis" requirement to sunset reviews. Unsurprisingly, developing countries ask for special treatment implying an increase of the "de minimis" level, and a higher imports negligibility threshold.

Of particular salience is the call for rendering compulsory rather than hortatory the imposition of lesser duties whenever the "injury margin" identified by the investigating authorities is lower than the subsidy margin. The proposal tabled by Brazil is one the hottest topics in the parallel negotiations on antidumping and could have an impact not less severe than the reform of the key rules on subsidy identification and countervailing measures in limiting the room for manoeuvre to exploit CVD proceedings for protectionist ends. It is particularly so if the new criterion were coupled with a strict implementation of the causal requirement in injury assessment, which subjects the imposition of countervailing duties to the demonstration that subsidised imports are causing injury and also provides that injury caused by other factors must not be attributed to them. It follows that countervailing duties could not be imposed beyond the quantified damage directly referable to subsidized imports if not to the subsidy itself.

It is unlikely, therefore, that the ongoing negotiations on subsidies and countervailing measures could result in substantial changes in the system that has taken shape in the last fifty years, with a strong acceleration in the Uruguay Round and its aftermath. The present division between prohibited and actionable subsidies – which since January 2000, has replaced the three–way classification also comprising non- actionable subsidies – is not destined to be significantly challenged.

This classification does not reflect any particular economic theory. For instance, as noted in chapter 1, export subsidies, which are prohibited, could be viewed as a misallocation of resources by the subsidising state and may squeeze out more efficient third-country producer, but for the importing country in most cases they entail more available products at lower prices. Likewise, quite a few subsidies are addressed at offsetting market distortions or at remunerating some externalities that are not recognised by the invisible but sometimes blind hand of the market. [9]

As argued in Chapter I, the choice to grant subsidies and to counter them, whether through international proceedings or, unilaterally, by countervailing measures, is determined by factors that do not fit into the perspective of static comparative advantage or the establishment of a level playing field. Factors like the consumption variable, that is, the capacity of an economy to absorb the external benefit provided by an industry either through upstream or downstream flows, and the internalisation variable, that is, the extent to which competitive

[9] See Chater 1, section 1.

benefits generated by subsidisation measures can spread beyond national borders and be exploited by industries in foreign countries are taken in account by the main players in the high technology sectors. And prominent among them is the United States. For instance, the United States along with Japan and the European Communities have heavily countervailed allegedly subsidised imports from Korea of dynamic random access memory semiconductors, after having lost in the 1980s large shares of the world market for semiconductors to Japanese giant conglomerates like Fujitsu, Hitachi and Toshiba enjoying the support of the MITI.[10] Likewise, the United States is still the main user of countervailing measures, along with antidumping measures against steel imports, a sector in which the United States lost ground since the early 1970s.[11] One could argue that the use of countervailing measures and the call for stricter rules on subsidisation measures simply reflects the fact that the United States does not consider subsidies as legitimate measures while most other countries consider them as a legitimate instrument of economic policy. However, the distinction is not so clear-cut as it might seem at first sight. Estimates prevalently based on the 1980s indicate that subsidisation as a percentage of GDP was 2.98% in most industrialised countries while the average rate of the US was 0.5%, but if defence procurement are taken into account the rate jumps to 2%[12]. Indeed, public support, if not subsidies, has been lavishly provided to the aircraft industry, which grew up as a strategic sector.[13] In 1992 the United States and the European Communities reached a bilateral agreement on aircraft subsidies, regulating and consequently recognising the right of the two customs areas to provide public

[10] See Peter H. Lindert, "Twentieth-Century Foreign Trade and Trade Policy", in Stanley Engerman, ed., The Cambridge Economic History of the United States Vol. III(Cambridge: Cambridge University Press, 2000), p. 448.
[11] Ibid. p. 424 et seq.
[1212] Michael Trebilcock and Robert House, The Regulation of International Trade
[13] Peter H. Lindert, "Twentieth-Century, op.cit., p. 445.

support to the sector. The fact that the European consortium steadily eroded the US supremacy and possibly the fact that the Communities and the four member states engaged in the Airbus venture went beyond the terms of the agreement led the United States to lodge a WTO complaint against alleged launch subsidies to the EU company.[14] The European Communities in turn lodged a complaint contending that the American rival Boeing had received illegal aid benefitting in particular from overpriced defence procurement contracts as well as preferential access to military and aeronautical defence programmes.[15] Thus, the question is whether the two parties will be able to reach an eleventh hour negotiated deal before the circulation of the opinion of the Panel and, as de rigueur, of the Appellate Body. The likely outcome is a reissue of the 1976 DISC case: both sides will lose before the DSB and neither will want to come into compliance. But as we have seen in the previous chapter, in spite of the claimed predominance of prompt compliance with the decisions of the Dispute Settlement Body and the consequent repeal of subsidising measures or at least of their effects, also the present WTO mechanism gives WTO members wide room for manoeuvre to defend their dominant interests delaying compliance with the decision as long as it is economically convenient and politically feasible. It is quite possible that the two litigants at the end of the day will find convenient to make a new bilateral agreement.

In short, the long-standing agreement on aircraft subsidies and the likely outcome of the ongoing dispute bears witness of the predominance of realism over the ideal of undistorted market. We give to the term realism a Waltzian

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[14] European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft. Request for the Establishment of a Panel by the United States (WT/DS316/6. 11 April 2006).
[15] United States - Measures Affecting Trade in Large Civil Aircraft. Request for the Establishment of a Panel by the European Communities (WT/DS317/5. 23 January 2006).

meaning.[16] Realists see states as those units whose interaction forms the structure of international political systems and consider them as rational and unitary actors which pursue their individual interests. When fundamental interests are at stake the main actors in the international economic arena, except for lip service, do not care about the pursue of free trade and optimal worldwide allocation of resources, which instead seem to have a particular appeal to legal theorists and, sometimes, to the WTO Appellate Body. The same can be said for countervailing duties, which do not aim at defending free trade or creating a level playing field, but simply at rebuilding the protection wall fixed in the schedules of concessions, whose effectiveness is eroded by subsidised imports. The mechanism is not designed to allow a reduction of the protective barrier: only an increase is possible, if it is used for protectionist goals.

In the medium run, therefore, no significant changes in the system can be expected. What we can expect is only some minor alterations that fit the interests of some of the main parties involved in subsidising and counteracting subsidisation measures, along with some limited improvements in regulating the use of subsidies and making exploitation of countervailing measures for protectionist ends more difficult.

[16] Kenneth N. Waltz, Theory of International Politics (Reading, Mass.: Addison Wesley, 1979), p. 95.

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